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CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES

HEARINGS
BEFORE THE
PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
NINETY-EIGHTH CONGRESS
FIRST SESSION

MARCH 15, 16, AND MAY 24, 1983

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CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES

TUESDAY, MARCH 15, 1983

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 9:30 a.m., in room 342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. William V. Roth, Jr. (chairman of the subcommittee) presiding.

Members of the subcommittee present: Senator William V. Roth, Jr., Republican, Delaware; and Senator Warren B. Rudman, Republican, New Hampshire.

Members of the professional staff present: S. Cass Weiland, chief counsel; Eleanore J. Hill, chief counsel to the minority; Rod Smith, deputy chief counsel; Chuck Morley, chief investigator; Katherine Bidden, chief clerk; Tom Karol, staff counsel, majority; Tom McLaughlin, staff investigator, majority; Terry Bostic, staff counsel, minority; Leonard Willis, staff investigator, minority; Marilyn Milian, John Maddox, Carla Dooley, Cindy Cappel and Carolyn Kulisheck, staff persons.

[Senator present at convening of hearing: Senator Roth.]

Chairman ROTH. The subcommittee will be in order.

[Letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C.

Pursuant to rule 5 of the Rules of Procedures of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the chairman, or any member of the subcommittee as designated by the chairman, to conduct open and/or executive hearings without a quorum of two members for the administration of oaths and taking testimony in connection with hearings on Crime and Secrecy: The Use of Off-shore Banks and Companies to be held March 15, 16 and May 24, 1983.

WILLIAM V. ROTH, Jr.,
Chairman.
SAM NUNN,
Ranking Minority Member.

OPENING STATEMENT OF SENATOR ROTH

Chairman ROTH. Today the Permanent Subcommittee on Investigations begins a series of hearings on an issue that we have worked on for 2 years and one that has frustrated law enforcement for many years: That is the use of offshore banks, trusts and companies to facilitate criminal activity in the United States.

What we have found during these 2 years is a problem that is pervasive and growing. It is also complex, because one of its main roots is a clear difference in philosophies. We disdain bank and corporate secrecy to the degree it is practiced elsewhere, whereas secrecy is exalted and protected in other countries—many of them our friends and allies.

And while we still don't know how much criminal money leaves the country and comes back again, we have collected scores of individual cases involving hundreds of millions of dollars—evidence enough that the total amount is substantial. For example, one money launderer whose story will be unfolded in these hearings laundered a quarter of a billion dollars in just 8 months.

During this investigation and others which the subcommittee has conducted we have repeatedly heard testimony about major narcotic traffickers and other criminals who use offshore institutions to launder their ill-gotten profits or to hide them from the Internal Revenue Service. Haven secrecy laws in an ever increasing number of cases prevent U.S. law enforcement officials from obtaining the evidence they need to convict U.S. criminals and recover illegal funds. It would appear that use of offshore haven secrecy laws is the glue that holds many U.S. criminal operations together.

But equally shocking is the fact that we have also found that offshore havens are no longer used exclusively on criminals. Instead they are increasingly being used by otherwise law abiding Americans to avoid paying taxes and to shield assets from creditors. As we will show later in these hearings, tax protestors have created what might be called a cottage industry by selling offshore trust packages for thousands of dollars each to a group of farmers in the Midwest who are determined to hide their income from the IRS.

Rather than read my entire statement I will incorporate it in the record as if read.[1]

We will proceed with the first witnesses. At this time I am indeed delighted to call forth a panel consisting of Lowell Jensen, Assistant Attorney General, Criminal Division, Department of Justice, and Glenn Archer, Assistant Attorney General, Tax Division, Department of Justice.

Gentlemen, as you may know, under our rules we swear in all witnesses. So if you will please stand, and raise your right hand: Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. JENSEN. I do.

Mr. ARCHER. I do.

Chairman ROTH. Thank you.

Please be seated and if you would each introduce yourself for the benefit of the audience.

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[1] See p. 207 for the prepared statement of Senator Roth.

TESTIMONY OF D. LOWELL JENSEN, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, DEPARTMENT OF JUSTICE; AND GLENN L. ARCHER, JR., ASSISTANT ATTORNEY GENERAL, TAX DIVISION, DEPARTMENT OF JUSTICE

Mr. JENSEN. Mr. Chairman, I am D. Lowell Jensen, Assistant Attorney General, Criminal Division, Department of Justice.

Mr. ARCHER. Mr. Chairman, I am Glenn L. Archer, Jr., Assistant Attorney General, Tax Division, Department of Justice.

Chairman ROTH. Gentlemen, we will of course include your statements in their entirety so that you can either read them or summarize if you so choose.[2] [3]

Mr. JENSEN. If I may, I appreciate that. I would like to submit the testimony for the record and perhaps summarize it, and then we can proceed with my contribution.

Mr. Chairman, I think you have already made a statement that addresses the nature and scope of this particular problem. If you go back in the history of this country, we started with a tradition of simply local crime, and part of the tradition was based upon the reality that transportation and communication were such that we lived in individual localities. That has long since passed. Because of current technology in terms of our mobility and our communications, we are not only one nation; we are one world.

We are now living in what is a world of transnational issues, and unfortunately those issues include all of the human conditions, including crime. We are dealing then with the dimensions of a criminal problem that extends throughout the United States and around the world, particularly the problem of how to prosecute offenders successfully who are in this Nation when we are able to use the facilities of the entire world.

There has already been an allusion to the amounts of money involved; the incentive of narco dollars is well known. There are other ways of measuring the problem of transnational crime. I may offer one way in terms of criminals themselves. The Office of International Affairs within the Criminal Division of the Department of Justice deals with the issue of international extradition; that is, offenders who commit their offenses in the United States and then become international fugitives or vice versa where persons who commit offenses overseas then become fugitives in this country.

In the 1960's perhaps 20 of such extradition requests were prosecuted annually. In 1978 that number had risen to 100; in 1982 we processed 338 international extradition requests, an enormous increase. That is really the tip of the iceberg in that international extradition is very expensive and very complicated; only the most important cases reach the stage where we actually seek formal extradition. I think that is an index of the kinds and the nature of criminal conduct that faces us.

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[2] See p. 210 for the prepared statement of D. Lowell Jensen.

[3] See p. 234 for the prepared statement of Glenn L. Archer, Jr.

The other point made, that I would echo, is that the kind of criminal activity in issue is not limited just to narco dollars. It includes the flow of narcotics, a subject which we will address. However, I think the point ought to be made that we are dealing with other kinds of crime. In my testimony I make reference to an example of a very sophisticated commercial fraud scheme that was recently prosecuted here in the District of Columbia involving the Raytheon Co. Raytheon, which had awarded shipping and construction contracts for a Raytheon project in Saudi Arabia, was the victim of a scheme to defraud it of over $2 million.

The people who perpetrated this scheme put the money they gained from the fraud into a Swiss bank. By the time we were able to track the money from place to place, we found it had gone through banks in Switzerland, Liechtenstein, Bermuda, and the Cayman Islands; it was enormously difficult task to follow that money.

I think I made reference to the prosecutors and investigators involved. That point is we are dealing not only with narcotics traffickers but also with people who use the proceeds of their criminal activities in international trade. Therefore, I think, Mr. Chairman, your point is well taken.

[See charts in Exhibit No. 10, p. 109–111 and case description on p. 228 to 233.]

Chairman ROTH. I would like to just point out that in this subcommittee we have had hearings that showed the corrupt have milked the Federal Government under home health care for example, then taking the ill-gotten gains and fled down or laundered the money through the Caribbean.

Mr. JENSEN. I think that is exactly right. I am sure there will be examples provided.

Chairman ROTH. So government itself has the problem directly.

Mr. JENSEN. I think I should say that when we talk about these issues—when we say that we are dealing with problems of bank secrecy, havens, or tax havens—we should recognize, of course, that there is a real interest, a legitimate and positive interest, in the privacy of financial transactions. This country has the Right of Financial Privacy Act with reference to those transactions. The real point is that given the privacy interest, there also has to be a parallel interest in the legitimate law enforcement need to enforce the criminal laws of the country so that there is an effective and efficient way of piercing the bank secrecy provisions.

That is really what we are dealing with. We want to be in a position that allows us an effective way to deal with the issue of bank secrecy or bank privacy when we are faced with a law enforcement need. Our present structure is such that we can use letters rogatory and other methods to seek information from foreign banks. We have had success in the recent past in using subpena power over the U.S. branches of foreign banks in order to obtain financial records.

In the testimony I cite a case, *United States* v. *Bank of Nova Scotia*, that I think is important for the hearing. As you can see there is a present ability to deal with this problem. However, I think the present ability is one that is more costly and more time-consuming than it ought to be when we are dealing with the issues involved in trying to pierce bank secrecy more effectively.

As we address these issues, I think it is necessary to survey exactly where we are. As you know, we recently had a conference which was sponsored by the Criminal Division and the Tax Division of the Department of Justice involving all of the investigative agencies that have an investigative responsibility in the area of offshore banking. The Department of Justice, the Treasury, the Comptroller of the Currency, the Postal Inspection Service, and Interpol were there and, Mr. Chairman, you were kind enough to grace that conference with a presentation. We most appreciate it. We think that conference was a good start in terms of the problems of interagency cooperation; it identified problem areas where we can go forward.

What we have suggested in my testimony is a reference to our present practices and the present problems that may be part of the picture of international enforcement. We also suggested areas of interagency cooperation and topics of legislative concern within the testimony. They deal with such issues as statutes of limitations and changes in the definitions of some crimes. I think what I would simply like to say is the perspective that this is a critical problem for the country in terms of our law enforcement is absolutely correct; we need to address it with clear eyes and to evaluate our present abilities and the potential framework of an adequate legislative structure.

With that, I would submit my testimony and be happy to answer questions.

Chairman ROTH. Let me just ask two or three questions before we go to the testimony of Mr. Archer. Then I will ask both of you a series of questions.

You make a very telling point that the question is, where do you draw the line on secrecy? I think we, in this country, feel very strongly about the right of privacy. So it is something that cannot be ignored. A law-abiding citizen does not necessarily want to have to expose everything to law enforcement people. At the same time, there is no question that it is this cloak of secrecy that is making possible the evasion of our laws and, as both of us have said earlier, it is a glue that makes many of these criminal operations possible.

One of my concerns is that the situation is so extraordinarily complex for you to try to investigate and prosecute, one major case takes tremendous resources and manpower. So yet we find this whole situation exploding.

Do you have any idea, any figures as to what number of people are sending money offshore? Are there any guesstimates on that?

Mr. JENSEN. No. Perhaps some of the other witnesses may have a better handle on that, but it is pure speculation. I use the figure of international extradition simply as an index. It seems to me that it is an appropriate index because over a 4-year period, we find that the number has tripled. As I said, that is simply symbolic of the kinds of criminal activity involved. If we are looking at the absolute nature of this, I think you can measure it in terms of billions of dollars, but in terms of the people and the scope of this, I think we are dealing with an exploding problem.

Chairman ROTH. One further question. In your testimony, you mention that the best legislation on the books is the bilateral agreement between Switzerland and the United States. Switzerland has some very strong secrecy laws that I gather were instigated during World

War II as a means of protecting Jewish people in Germany. That was a very legitimate purpose. So secrecy isn't always bad. I think that is something we have to keep in mind.

At the same time, as you look around the world, you will find many small tax havens. Are you aware whether or not any effort at any international level has been made to try to negotiate similar agreements on a broad multicountry basis?

Mr. **Jensen**. There are ongoing efforts to do precisely that. Around the world there is no central kind of negotiation that involves in effect the higher spectrum of the people involved. This is an important point. As we faced the expansion of criminality to a national level, we were able to deal with that in terms of Federal and State law. There was one country, and we could deal with crime problems of national scope within our own legal structure. As we tackle transnational crime, however, we have to deal with the legal structure of other countries and the sovereignty of those countries.

So the best way to do it, the most appropriate and effective way—in fact, the only way—is through true bilateral treaties or through treaty activities. We use the Swiss example, as was precisely your point, as a good example of a treaty that provides mutual assistance in investigative effort. We are negotiating treaties. We have a mutual assistance treaty in force with Turkey, and treaties with Colombia and the Netherlands, including the Netherlands Antilles, have been advised and consented to by the Senate and are awaiting ratification. Attorney General William French Smith was recently in Italy and signed a mutual assistance treaty with Italy.

We have negotiations on with Jamaica at the present time. There are other areas as well. I am just mentioning those that come to mind.

Chairman **Roth**. I guess the question I am raising is, wouldn't it be desirable and practical to try to obtain an agreement such as the GATT—a general agreement that many countries have signed and are regulated by? Wouldn't this be an area—whether it be possibly the United Nations or some other forum—where we could get all countries in agreement? Couldn't we attempt to get such a massive agreement? I would assume that this problem is not peculiar to the United States.

Mr. **Jensen**. It certainly is not. Our experience has been that there is a mutuality of assistance; that is, the investigative agencies overseas have need for the same kind of information that we do. There is this mutuality problem. I do not know whether or not you could resolve that in one specific sitting; if it would be good, we could certainly conceive of it, but I am not sure we would be able to accomplish it.

Chairman **Roth**. I doubt that you could although it does seem to me that it might be an avenue we should explore.

[At this point, Senator Rudman entered the hearing room.]

Chairman **Roth**. At this time rather than continuing the questioning, I would like to call on you, Mr. Archer, for your statement.

Mr. **Archer**. Thank you very much, Mr. Chairman, members of the subcommittee.

I appreciate this opportunity to be invited to testify before this subcommittee on the problems of offshore banks and other foreign entities. I believe that these hearings, in light of the increasing misuse of offshore jurisdictions, are very timely and will be very helpful in our efforts as law enforcement officers.

At the outset, I would like to take just 1 minute to place the Tax Division's role in perspective. The detection, selection, and development of criminal cases is primarily the responsibility of the Internal Revenue Service. The Tax Division, after the cases have been developed, is responsible for authorizing prosecutions and for authorizing grand jury investigations.

The Tax Division also assumes direct responsibility for conducting tax grand juries and tax prosecutions, but many of the grand jury investigations and prosecutions are handled by the U.S. attorneys around the country.

In the cases that we have been involved with, there are often offshore transactions involved. Our staff also works closely with the Criminal Division, particularly the Office of International Affairs, in treaty negotiations, and advises the Treasury Department's International Tax Council concerning exchange of information provisions of tax treaties. We also assist the U.S. attorneys with regard to foreign information-gathering problems, including the initiation of formal requests under tax conventions and mutual assistance treaties.

The use of offshore banks, corporations, trusts and other entities located or formed in foreign countries for illegal activities creates some of the most difficult and vexing problems facing those of us in tax enforcement.

Senator **Rudman**. I wonder if the witness could pull the microphone a little closer. With the air-conditioning it is a little hard to hear.

Mr. **Archer**. The cases include the laundering of profits, both from legal and illegal business activities, and the use of nominee entities and fictitious transactions to create tax shelter deductions and to promote various tax protestor schemes.

Money laundering of course is not confined to the tax area. It impacts many other criminal priorities such as narcotics, securities fraud, organized crime and others. Overall, money laundering has become one of the most important and vital aspects of criminal activity generally.

In solving these offshore crimes, the investigator and prosecutor are faced with several significant difficulties: First, discovering where and when money laundering, fictitious entities, and sham transactions have occurred or are being used; second, obtaining sufficient information and leads to follow the complex schemes that are employed; and, third, securing documents, testimony and other evidence that will be admissible in court to prove the criminal violations.

Enormous resources, both on the investigative side and on the prosecutorial side, must be committed to convict the perpetrators of unlawful offshore activities and, in the case of tax crimes, additional resources are necessary to proceed with the audits and investigations necessary to determine civil tax liabilities and thereafter to collect such liabilities.

In January 1981, Mr. Richard A. Gordon, prepared a report entitled "Tax Havens and Their Use by the United States Taxpayers—an Overview" that has come to be known as the Gordon report. The principal finding of that report is that the legal and illegal use of tax havens appears to be on the increase by taxpayers ranging from large multinational companies, to small individuals, and to criminals who are making extensive use of tax havens.

Despite these findings, too few people are adequately informed of the pervasiveness of the use of tax haven countries for these illegal activities. As in many areas, I think it is frequently difficult to combat a crime problem without a strong public awareness and concern.

As has been indicated, there are no reliable statistics regarding the amount of money that is being laundered through tax havens and offshore jurisdictions. There are several indications which we can see, however. I would just like to cite a few examples.

One indication of the problem is the Federal Reserve information on the net cash surpluses that have grown dramatically in certain areas. Miami, in particular, has surpluses which grew very much as drug trafficking became a problem in the Miami area. An enforcement project called Operation Greenback which involved the detection of money laundering was conducted by the IRS, Customs and representatives of the Department of Justice and it has caused some dramatic shifts. In one area adjacent to Miami, for example, the net cash surplus grew from $304 to $835 million in a single year and it is believed that this shift was caused by the success of Operation Greenback in Miami.

Another way of looking at it is the growth of the banks in the Caribbean Islands. In the small island of Anguilla, there were only three banks 3 years ago, but today there are reportedly 96 banks. Of those 96 banks, only 1 apparently has a vault. There are paper banks being marketed in many tax haven countries. They are being marketed to people in the United States. Brokers of these banks often intimate, although they usually don't state directly, that the offshore paper banks can be used for illegal purposes or concealment.

One piece of promotional material that we have seen advertising the advantage of being the first on the block to own your own bank describes a means of increasing net worth by recycling funds and concludes, and I quote:

> Theoretically this process may be recycled over and over again. However, its overall effect after several recyclings would appear to be fraudulent. Therefore, this technique should be used like sugar in coffee, very sparingly.

Many other examples could be cited including many prosecutions by the Criminal Division, by the Tax Division and by the U.S. attorneys. Many of these cases are detailed in section 2 of this subcommittee's staff study. Suffice it to say we believe that the scope of the tax-haven problem is huge and that efforts to combat it have not reached a desirable and necessary level. All law enforcement agencies dealing with these problems believe that the use of the offshore banks and other entities for illegal purposes continues to grow.

There are a number of current things which are being done in the Department of Justice and I would like to point out just a few of these.

The Attorney General's program on narcotics, creating drug task forces, is going to focus to a large extent on financial dealings and financial bankers of narcotics trafficking, including the money-laundering aspects of the narcotics trade.

As Mr. Jensen noted, our division and the Criminal Division jointly sponsored what we considered a very productive conference on the methods of obtaining evidence abroad in connection with criminal prosecutions and we brought together for the first time a large representative number of assistant U.S. attorneys from around the country who had had experience in obtaining foreign-source evidence.

Also attending that conference, as Mr. Jensen has mentioned, were representatives from all of the investigative agencies that are concerned with these problems.

The President's Caribbean Basin Initiative, I think, is another important development. This legislation contains provisions that hopefully will encourage some of the Caribbean countries to relax bank secrecy through the negotiation of bilateral agreements with the United States.

The basic carrot-and-stick approach there is that a tax incentive, the convention tax deduction rule, will be extended to these countries, but only after they have negotiated effective bilateral agreements on the exchange of information and have those agreements in place.

These agreements are not the ordinary, exchange-of-information types of agreements but would provide information similar to that available in mutual assistance treaties, only relating to tax matters.

They will cover both civil and criminal tax matters. They will provide that the information to be turned over by the foreign countries must be in a form usable as evidence in court proceedings.

Of course, not all of the Caribbean countries with bank and commercial secrecy laws are equally dependent upon tourism, but we think that this proposed legislation is certainly a step in the right direction.

Another development is the effect to include stronger exchange of information provisions in tax treaties. We, in the Justice Department, are particularly pleased with the coordination and cooperation we are receiving from the Treasury Department.

Both the Tax and Criminal Divisions have been provided the opportunity to assist the Treasury Department in formulating policies, and specific treaty provisions.

We are hopeful that some of these negotiations may result in effective exchange of information provisions in newly negotiated tax treaties.

There have been in the litigation area some recent developments which I think are helpful to us. The most important cases in the tax context are *Vetco*, decided in the 9th Circuit in 1981, and *Bank of Nova Scotia*, decided in 1982.

In the court *Vetco* upheld the enforcement of an IRS summons issued to Vetco for records of its Swiss subsidiary, concluding that the strong American interest in collecting taxes and prosecuting tax fraud justified an instrusion on Switzerland's interest in preserving the secrecy of such records.

In the 11th Circuit, *Bank of Nova Scotia* case, the Government was successful in obtaining bank records from the Nassau branch of a bank that also had a Miami branch on which the subpena was served.

There was no question of jurisdiction in that case. The bank argued that compliance would have subjected the bank to criminal liability. But, again, the balancing test was applied and the court concluded that the investigative function of the U.S. grand jury outweighed the secrecy interests of the Bahamas.

We think that the potential for damage to our voluntary tax system by misuse of offshore banks must be recognized and every effort must be made to deal with the problem.

I am certain that this subcommittee will build the record that will result in positive legislation and administrative recommendations and we are very encouraged that this hearing is being held.

Thank you very much, Mr. Chairman.

Chairman **Roth**. Thank you.

The testimony of both you gentlemen is most helpful.

Let me try to scope out the dimension of the problem.

I gather from your testimony that we are not talking about a few bucks or even a few billions of dollars. We are possibly talking literally billions and billions of dollars that are fleeing the country either because they are ill gotten under some corrupt scheme or, as in many cases, are the result of legitimate operations hiding their income because there are a growing number of people willing to evade paying their taxes. They are tax cheats, in other words.

So, you have got two separate problems, basically, don't you? You have the one dealing with the corrupt, the organized crime, narcobucks and the white-collar crime, which is a tremendous horrendous problem in itself. But is only part of it.

The other side, in some ways certainly as much of a concern to Government, is the fact that you have an opportunity for otherwise law-abiding citizens to evade paying taxes. So that is an entirely different problem, although they are very much interrelated. Those people in many cases are essentially and will look upon themselves as law-abiding citizens; isn't that right?

Mr. **Archer**. I think that is absolutely right. We have, of course, seen this in some of the tax shelter promotions and in the tax protester types of schemes.

In many instances, I think that the investors in either the tax shelters or the tax protester schemes often are aware of the foreign connection. In other cases they are, like in the tax protester schemes, where the foreign trust has been set up as a vehicle to avoid any taxes in the United States.

Mr. **Jensen**. I think the point could be made that it is a multiple problem. It is not only legitimate money going into a haven kind of status. One of the purposes of financial investigations is to identify the offenders, not simply to track the proceeds and profits. When we conduct financial investigations, they are part and parcel of the entire process in the investigation to identify the offenders, to build cases, and to prosecute.

Chairman **Roth**. One of the things that seems clear to me is that if you are really going to successfully attack a problem, much of the effort has to be done administratively. We have to somehow—Congress, and Government itself—wrestle with remedies that don't depend on extraordinarily complex investigations and criminal prosecutions. There are two reasons for this approach: The problem is pervasive and it is growing, I guess, every day in dimensions.

But the other side is that the complexities of the investigations are enough to tax the very resources of our Government.

We are not really just talking about one tax haven. We are talking about any number of tax havens scattered throughout the world. In many cases, the more complex schemes involve the moving of funds through many countries.

Mr. JENSEN. As I point out, we cited an example in the testimony simply for that purpose—to show the flow of money through a number of countries. I also have to make a point that the status of a tax haven with respect to the ability to launder funds and to protect the identity of offenders is such that it isn't the location of the tax haven, but rather the concept, which matters.

If you are able to get at a specific area where you may be able to treat a problem effectively you will find it will go someplace else. You have to deal with the entire process.

Chairman ROTH. It is like sticking your finger in a dike.

Mr. JENSEN. If you can find it.

Mr. ARCHER. There are many entities: Not only does the money move to many countries, but there are many entities that are used within the same country as well.

For example, the paper banks will throw money into a more legitimate bank and also they will be using trusts and corporations to disguise the trail. So really each investigation and prosecution is a major resource intensive problem.

Chairman ROTH. Let me ask you this question:

Why would any country, or island, or region get involved in this kind of operation? Unquestionably in many cases, the government has to know that these funds are improperly being brought there. And I think most governments and most countries are honest, law abiding, and want to be cooperative.

What is the incentive for these countries to get involved in this kind of an operation?

Mr. JENSEN. Very quickly, I think it gets back to the issue of the tension between legitimacy and privacy and the problem protecting law enforcement needs. There are situations where bank secrecy is part and parcel of a government policy that it is appropriate, and we need to address it in terms of whether or not such secrecy now shelters against law enforcement investigations.

Chairman ROTH. Aren't, in many cases, the reasons economic? Particularly don't some of the small countries have tough economic problems? Their resources are limited. They have high unemployment, and the fact is, whether we like it or not, this kind of an operation does mean resources, substantial resources to particularly some of the very tiny countries.

Mr. ARCHER. That is absolutely correct. Most of the tax-haven countries have economic problems.

They are small islands that don't have resources to develop an economic base otherwise.

Chairman ROTH. Let me ask you this:

What makes a tax haven? One consideration is secrecy. That is paramount, that once the money, whether it is criminal, corrupt money, or whether it is the result of legitimate operations, once it escapes behind this cloak of secrecy, then it is almost impossible or extraordinarily difficult for our law enforcement officials or anybody else to trace what is happening to that money, even if it reenters back into this country; isn't that correct?

Mr. **Jensen**. That is correct. Once again, the problem is to look at it from the perspective of the ability, effectively and efficiently to penetrate bank secrecy when there is a legitimate law enforcement need.

The criminal investigative process has to proceed in a timely fashion; if you do have a bank that is protected in such a way that you cannot ever get there in time to use it in an effective way as far as Federal prosecution is concerned, then it becomes a tax haven or criminal case.

Chairman **Roth**. A second aspect of such a haven—I am trying to define the exact characteristics of a haven—would be very little local taxation; is that correct?

Mr. **Archer**. Very little local taxation on foreign money that comes into the country. Little or no taxation on that type of thing.

Chairman **Roth**. What are the other attributes of a haven?

Are those the two significant ones?

Mr. **Archer**. Those are the two significant ones.

Chairman **Roth**. Mr. Jensen, last year I introduced S. 1907 to amend the Bank Secrecy Act. I take it from your prepared statement that you are in favor of such an amendment?

Mr. **Jensen**. Yes; I am in favor of the basic outlines of that legislation.

Chairman **Roth**. We are very pleased to have the vice chairman of the subcommittee here, a gentleman who also served as Attorney General. So he knows the problems. He has been out in the real world.

Senator Rudman.

Senator **Rudman**. Do you imply this isn't, Mr. Chairman? [Laughter.]

Thank you, Mr. Chairman.

I just have a couple of questions.

First, it is alleged, generally, that one of the motivations for some of this activity are the revenues that are generated by those banks located in these places, license fees, employment for people, and so forth; and that one of the reasons these governments are rather reluctant to do the kinds of things that we would like to have done is that it would have really nothing in it for them.

We would collect more taxes but they would lose employment, lose licensing fees, lose revenues.

Is that an accurate allegation?

Mr. **Archer**. Some of the countries have very little incentive to cooperate in relaxing their bank secrecy laws or their other privacy laws just for that reason, Senator.

It is an economic base for them which they would not otherwise have if the word gets out that the secrecy is not available in that country.

Senator **Rudman**. So, in diplomatic talks with us, with the State Department, with the Justice Department, they can talk about the right of privacy for individuals but that really can be a shield for what is essentially a major concern if they repeal these, even if privacy can be kept to some degree.

They would lose a great deal of revenue because, obviously, the money would move from that locality to some place else.

Is that accurate?

Mr. **Jensen**. That is correct.

Mr. **Archer**. That is correct.

Senator **Rudman**. We hear a great deal about the problems within the hemisphere. We heard it from a number of witnesses involved with other kinds of hearings.

Is there any task force set up within Justice or to your knowledge, within Treasury, working with the Bahamian Government to rectify some of the alleged problems that exist there? Whether they do or don't, I do not know but there are allegations that they exist in some of the Bahamian Islands.

Mr. **Jensen**. There have been discussions at very high levels of this government, the Bahamian Government, on that issue. Some of them grew out of the south Florida task force. They were discussions that had reference to the impact of this in terms of narcotics trafficking.

So the answer is yes. There are negotiations. There are discussions in terms of our mutual interests as far as the problems generated by bank secrecy are concerned.

Senator **Rudman**. What incentives could we offer to a government like the Bahamian Government to have them open up their records, particularly as they relate to U.S. citizens and U.S. domestic corporations or foreign corporations that are domiciled in the United States?

Mr. **Jensen**. Perhaps Mr. Archer can address this.

Mr. **Archer**. Let me do it very quickly. One of the major incentives is our mutual interest in stopping drug trafficking, particularly where the Bahamas become transshipment or funding points. In mutuality of interest, the countries stopping the drug traffic will break them.

There is at least one incentive level in the Swiss treaties. We have had a situation where seized money that has been identified as being drug money is forfeited to the Swiss Government. The incentive in that respect is to be able to take the proceeds from drug trafficking and to forfeit them to the haven country.

Senator **Rudman**. Mr. Chairman, I ask these questions only because I know we are going to have extensive hearings and the staff has done an excellent job in lining up witnesses, but obviously, we would like to take their testimony along with other committees and develop some needed legislation.

I really have some problems of how you design that legislation when the benefit would accrue to us and there would be some disadvantages to those other countries.

It is not that they probably desire to be dishonest as the chairman said. I doubt that very much. But they do have their own domestic political problems to be concerned about. So to be practical, if we are going to have any kind of solution here in the Bahamas, some of the other islands that are independent, some of the countries in Europe, then we are going to have to have something that will make it worth their while.

I am not sure what that is, but there ought to be some way to come up with some incentives.

Mr. **Archer**. Senator, that is important to some of these tax-haven countries. As I indicated, the Caribbean Basin Initiative would provide tax benefits to the Caribbean countries provided that they entered into these bilateral agreements for the exchange of information. That is a step forward. But it is certainly not a solution.

Senator **Rudman**. It is a step. It is a carrot and stick but I think we have it in the wrong order. Obviously if we pass these initiatives and they are signed by the President, they would not be an incentive in terms of getting income back.

It seems to me, we often do things a little bit backward. We ought to have a scenario laid out that if we do certain things, then we will get certain things in return. That is not the case here.

Mr. **Archer**. The tax benefits under that legislation, however, would not be provided until the agreements were in place between countries. So that is in the right order, I think, there.

Senator **Rudman**. I am glad to hear it.

Thank you, Mr. Chairman.

Chairman **Roth**. Thank you.

I believe the staff director, Mr. Weiland, has one question and then we will keep the record open so additional questions can be answered in writing if you gentlemen agree.

Mr. **Weiland**. Mr. Chairman, I would like to submit one document for the record: That is the staff study that has been prepared for these hearings as exhibit 1. Then I have one question for Mr. Jensen.

[The document referred to was marked as "Exhibit No. 1," for reference, and may be found in the files of the subcommittee.]

Mr. **Weiland**. On page 13 of your statement, you mentioned restrictions on U.S. agencies in terms of their ability to share information among themselves.

Last year, Senator Nunn, Senator Roth, Senator Rudman, and others, were successful in amending the so-called Tax Reform Act to facilitate exchange of information.

Can you tell us what other restrictions remain that Justice would like to see some action on?

Mr. **Jensen**. That was an improvement, I think, in this problem of the flow of information. It didn't go as far as our original proposal in terms of the actual flow. It was more of an assistance in terms of making the process more contemporaneous and easier to implement. There are still restrictions concerning the absolute flow of information that are contained within those sections that we have suggested ought to be removed.

We would be happy to provide you more information in that area.

I am simply addressing it as a general topic. We have some specific suggestions that we will provide to you.

Chairman **Roth**. Gentlemen, thank you, very much.

We look forward to working with you. At this time, I call forward Mr. Egger, who is the Commissioner of the Internal Revenue Service; Richard Wassenaar, Assistant Commissioner; and Percy Woodard, Assistant Commissioner.

Gentlemen, please raise your right hand. Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **Egger**. I do.

Mr. **Wassenaar**. I do.

Mr. **Woodard**. I do.

Chairman **Roth**. Please be seated.

I want to express my appreciation for having you here once more and we are looking forward very much to your testimony on this extraordinarily complex and pervasive problem.

TESTIMONY OF ROSCOE L. EGGER, JR., COMMISSIONER, INTERNAL REVENUE SERVICE; RICHARD C. WASSENAAR, ASSISTANT COMMISSIONER FOR CRIMINAL ENFORCEMENT, INTERNAL REVENUE SERVICE; AND PERCY WOODARD, ASSISTANT COMMISSIONER FOR EXAMINATION, INTERNAL REVENUE SERVICE

Mr. EGGER. Thank you very much, Mr. Chairman, members of the subcommittee.

I am pleased to be here to talk about the problems that are caused by these offshore tax havens and the money laundering and other related activities as well as how we in the Internal Revenue Service are attempting to deal with them. We appreciate so much the opportunity to comment on this important topic and to share with you some of our insights in the nature of the problem and in some of the steps we are taking to try to deal with them.

Before I begin, let me introduce the people with me. On my left is Assistant Commissioner for Criminal Investigation, Mr. Richard Wassenaar and Assistant Commissioner for Examination on my right, Percy Woodard. We will be available, Mr. Chairman, to answer any questions that you or the subcommittee may have. What I would like to do is summarize very briefly the statement and then have the entire statement be submitted for the record.[1]

Chairman ROTH. Without objection.

Mr. EGGER. I am certain that members of this subcommittee are pretty familiar with the offshore tax havens. I would like to take just a minute to briefly define that term for the benefit of the people here who may be new to the area.

Tax havens have been loosely defined to include countries having low or zero rate tax on all or certain categories of income. At the same time offering a level of banking or commercial secrecy. Most tax havens also possess modern communications systems, a general lack of currency controls, an aggressive policy on self promotion, and no particular extensive involvement in tax treaties. If we apply this kind of definition too literally it can cover a lot of countries that are not in our judgment tax havens but it could exclude some that are.

For instance, some tax havens do have tax treaties with us. However, I am sure anybody familiar with this subject knows one when he sees it regardless of the precise definition. Over time these nations seeking recognition as tax havens have been pretty successful and they attract the attention that they are seeking. From our perspective at Internal Revenue the problem with tax havens is pretty clear. Two words: Tax evasion.

The ultimate effect of the numerous subterfuges and machinations which we will describe and which will be described by other witnesses in these hearings is simply to evade taxes.

We can't say with any real precision any more than others can as to the precise amount of revenue or tax revenue that is being lost through these things but it is simply clear that the amounts are in the multiple of billions of dollars. We did a little bit of quick looking at the forms that are filed with Customs for money being brought into the country either in suitcases or in the form of financial instruments of one kind or another and we noted that the amounts that were reported as being brought into the United States from certain countries amounted to over $4 billion while the amounts exported to those countries and reported, was only a little over $200 million. So we are satisfied that the amounts are staggering.

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[1] See p. 253 for the prepared statement of Roscoe L. Egger, Jr.

We share your concern about the pervasive nature of the situation and agree that the crimes involved here are not victimless. From our perspective the real victims in this whole widespread evasion are the honest taxpayers in this country who do pay their fair share of the tax burden while an unscrupulous handful of individuals are evading their responsibilities. This situation is unhealthy for our voluntary self-assessment system because to a considerable degree the activities in these tax havens involve narcotics traffickers and other elements of organized crime and it is equally unhealthy for the economic and social structure of our country as a whole.

We are concerned as you are with the growing number of seemingly law-abiding persons of moderate means who are using offshore banking facilities and other offshore entities as a means of tax evasion. We believe many such people are learning of these tax havens through the efforts of unscrupulous individuals who are marketing tax dollars using offshore banking facilities, and other connections.

There is a known trend toward the brokering of banks, that is, for a price you can create or buy your own bank for the expressed purpose of evading or certainly avoiding tax liability.

I would like at this point to congratulate you, Mr. Chairman, and the members of this subcommittee and certainly your staff for your continuing efforts to focus national attention on this vital issue.

Similar efforts by the late Congressman Rosenthal and his staff which we understand will be continued by the new subcommittee chairman, have also been very effective over time. I believe the first step in finding solutions to the problem posed by offshore tax havens is to fully educate other Members of Congress and the public at large on the true role these tax havens are playing in the international financial world.

The Internal Revenue Code as well as other portions of the United States Code make it a felony for anyone to willfully evade a tax imposed by the U.S. Government or to interfere with the lawful functions of the Treasury Department in collecting income taxes. In enforcing these laws in an international setting the Internal Revenue Service encounters numerous operational, legal, and even diplomatic problems. By far the most pressing problem, however, is accessibility to information or perhaps I should say the lack of accessibility.

The problem here is not so much one of substantive tax law but of getting the information to carry out our enforcement activities. The secrecy provisions of the law in the offshore tax havens create a veil which we often have extreme difficulty in penetrating in any effective fashion.

Let me give you just a couple of examples which I think will demonstrate the nature of our information problems in tax haven countries.

My first example is a scheme that has been sold to a number of U.S. persons operating businesses or professional corporations. The U.S.

person transfers the business entity or the business to a domestic trust and simultaneously establishes three foreign trusts in a tax haven country.

Foreign trust No. 1 is formed at his direction by a foreign person whose only function is to establish and act as trustee for foreign trusts No. 2 and No. 3. Let me interrupt, Mr. Chairman. We do have charts of these examples here.

[The charts referred to were marked "Exhibit No. 2," for reference and follow:]

EXHIBIT NO. 2

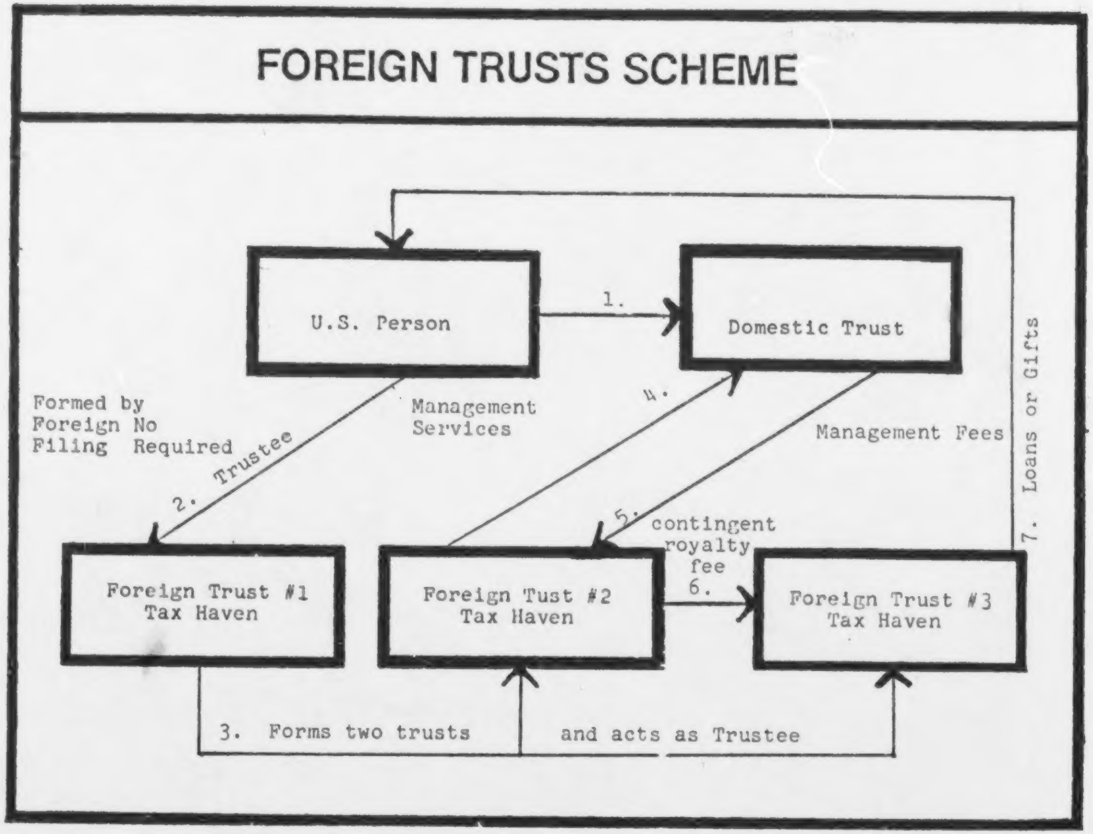
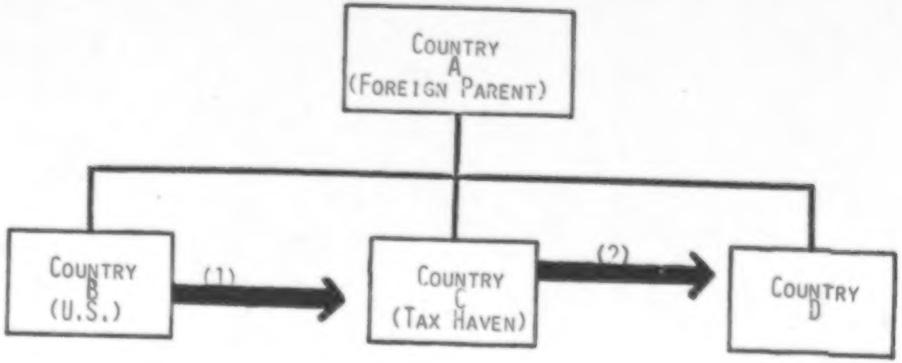

FOREIGN TRUSTS SCHEME
U.S. Person
1.
Domestic Trust
Formed by
Foreign No
Filing Required
2. Trustee
Management
Services
4.
Management Fees
7. Loans or Gifts
5. contingent
royalty
fee
6.
Foreign Trust #1
Tax Haven
Foreign Tust #2
Tax Haven
Foreign Trust #3
Tax Haven
3. Forms two trusts
and acts as Trustee

EXHIBIT NO. 2



Country A is the foreign parent of and sole owner of Countries B, C, and D. Country A reduces its worldwide tax by establishing Country C (tax haven) to act as a selling company for sales of tangible goods between other related companies in the worldwide group. Country C acts as a conduit through which income is siphoned away from related Countries B and D.

Transaction 1 - Country B (U.S.) manufactures goods and sells them at a price lower than fair market value to Country C. The goods are shipped directly from Country B to Country D. The sale of goods at lower than fair market value price reduces taxable income, and therefore, tax to be paid in Country B.

Transaction 2 - Country C (tax haven) resells the goods purchased from Country B to Country D at a price higher than fair market value price. Country C does not receive the goods nor add any substantial value to the goods. The only function performed by Country C is one of billing for the resale of goods to Country D.

Country D purchases goods at higher than fair market value price, thus, increasing its expenses and reducing its taxable income, and consequently its tax to be paid in Country D.

Mr. **Egger**. It might be helpful to the members of the subcommittee to take a look at the chart. This chart here shows the foreign trust scheme which I am presently describing. Foreign trust No. 1 as I say is formed and its function is to establish a trustee for foreign trust No. 2 and No. 3. The purpose of establishing foreign trusts in this manner is to avoid U.S. filing requirements on the establishment of the foreign trust. Foreign trust No. 2 makes a charge for management services allegedly rendered to the domestic trust, that is the U.S. business for which it receives a management fee.

This fee is in effect all the profits from the U.S. business. Because this fee is considered U.S. source income, foreign trust No. 2 must file a return on 1040NR, will report this income. However this return will not show the name of the U.S. business involved and the fee income in turn is distributed to trust No. 3 who makes a charge called a contingent royalty fee for which deduction is then taken on trust No. 2.

This in effect pours all of the income over into foreign trust No. 3 and since it has then no U.S. source income it would not be technically required to file a U.S. tax return except of course for the subterfuge. But since it ends up with all the profits those profits get back to the U.S. person and they do through the guise of loans or even gifts in order to return the money to the U.S. person.

Another scheme which we might briefly describe here involves a foreign parent corporation having worldwide operations including subsidiaries in the United States, a tax haven country, and a treaty partner country.

The U.S. subsidiary manufactures goods which are sold to the subsidiary in the tax haven country. Although the goods are sold to the tax haven country, they are shipped directly from the United States to our treaty partner country. The subsidiary in the tax haven country without adding any material value, resells the goods to the third subsidiary located in a treaty partner country at an increased markup in its purchase price, thereby, retaining a substantial profit in the tax haven jurisdiction.

In this example we can trace the transaction through the U.S. subsidiary to the tax haven country, but there the trail ends. Records in the tax haven country are inaccessible to us because of the secrecy laws in that country.

Fortunately in this particular example the ultimate customer is the subsidiary in the treaty partner country and through our simultaneous examination with the treaty partner and the exchange of information provision in our tax treaties the price charged to the treaty partner's subsidiary can be determined in cooperation with the treaty partner's tax administrators.

[See Exhibit No. 14 on p. 117 for additional examples of problems tax havens create for IRS.]

The IRS responses to the problems posed by offshore tax havens—let me briefly try to highlight some of our major actions in both the civil and criminal areas.

In the civil area the importance of international enforcement in the Service's examination programs has been increasing. For instance, examination's international enforcement program has made tax haven issues its No. 1 priority. Further, tax havens were made a mandatory referral item for international examiners in evaluating participation in an examination.

As I said earlier, Mr. Chairman, the greatest problem in our international examinations has been the lack of ready access to information. In conjunction with our treaty partners we are developing two major programs to combat this. The Service engages in simultaneous examinations with five treaty partners in an effort to better audit tax haven operations. Industrywide exchanges of information also is conducted with our treaty partners around the world to obtain comprehensive understanding of selected industry practices, particularly the use of tax havens.

Through these industrywide exchanges the Service can identify potential cases for simultaneous examination thereby targeting tax haven transactions. Our experience in these two areas establishes to our satisfaction that these activities are excellent approaches to dealing with the tax haven problems. The Fiscal Responsibility Act of 1982 gave us new powers to get books and records maintained in the foreign jurisdiction. Under the new code, section 982, if a taxpayer fails to comply with a formal document request arising from the tax treatment of an item, any court having jurisdiction over the civil tax proceeding may upon the Treasury's motion prohibit the introduction into evidence by the taxpayer of the foreign-based documentation unless certain subsequent conditions are met.

This sanction of nonadmissibility we believe is going to assist us considerably in enforcing document requests in various parts of the world.

Let me turn just briefly to the activities of our criminal investigation function. Over the past several years the Service has increased the amount of time that we have spent on investigations in the narcotics and other activities of organized crime in what we call the special enforcement program. We have committed up to 45 percent of our total criminal investigation staff to these activities. We have also increased the attention that we have devoted to the illegal tax protestor problem. We are now emphasizing better organization for targeting suspected drug financiers, promoters of fraudulent tax shelters and foreign trusts as well as organized crime figures—all of these are common, of course, in offshore tax haven tax activities.

We are convinced that firm, positive action is necessary if we are going to effectively address these problems. Let me just review briefly some of our efforts.

As I mentioned in the Appropriations Subcommittee hearings in the House last week our fiscal 1984 budget request is asking for an additional 220 positions at a cost of around $12.4 million to participate in the President's Task Force Against Organized Crime and Drugs. We think this expanded presence will allow us to increase considerably the pressure on these individuals in geographic areas that need attention the most. We are increasing our use of the information that is required to be reported under the Bank Secrecy Act through title 31, in identifying title 31 and title 28 for tax violations.

[At this point, Senator Rudman left the hearing room.]

Mr. Egger. Our specific use of currency transactions reports may be of some interest to you. In the Araujo investigation, this was the southern California case involving a large heroin distribution organization. This case was initially brought to our attention largely as a result of the currency transaction reports filed by a small bank near the Mexican border. Araujo operated one of the largest heroin distribution organizations in the country and made deposits totaling millions and millions of dollars into an account at this small bank.

This case concluded with Araujo and 16 others being convicted and sentenced on tax and other charges. Arajuo's unreported income tax in this case alone amounted to $13 million.

The Report of the International Transportation of Currency or Monetary Instruments which is the Customs form 4790, is another valuable tool under title 31. Currently we make use of this Custom's information generally in tandem with other information which we have as the basis to initiate or carry out criminal investigations of a wide variety.

We together with Customs have been the driving force behind Operation Greenback since 1980. To date this operation in south Florida represents one of the largest commitments of resources in the investigation of criminal activity in a single geographical area. For almost 2 years we have maintained a substantial commitment, more than 75 special agents are assigned to narcotics and laundering-type examinations, investigations in south Florida.

Currently, we have assigned to Operation Greenback alone more than two-thirds of the entire investigative effort in that particular operation.

Mr. Weiland. If I could just interrupt for a moment, Mr. Egger. Are you getting the tax prosecutions that you want out of Operation Greenback or are you seeing most of your investigations resulting in title 31 prosecutions?

Mr. Egger. Let me answer that in a fairly lengthy fashion as quickly as I can. Last year I got concerned about that and went to Florida, and sat down with all of our people including representatives down there from the Department of Justice, reviewed extensively the cases and the problems. What I learned on that occasion was that a lot of the cases that had gone forward on title 31 prosecutions alone simply hadn't been suited to title 26 prosecutions. But we are now developing as a result of our investigation down there a significant number of title 26 prosecutions.

That whole picture has now changed pretty dramatically. So I think we will see considerably different results down there now currently and in the future.

Mr. Weiland. Is our understanding correct that Greenback is overwhelmingly IRS and Customs oriented and not DEA and FBI?

Mr. Egger. I will ask Richard Wassenaar to answer that. But my response to that is that we are currently furnishing somewhere between two-thirds and three-fourths of the investigative manpower.

Mr. Wassenaar. Your comment is essentially correct. It is my understanding that IRS is the single largest contributor to Greenback, supported in large part by Customs. However, DEA is somewhat involved. The number of agents assigned to Greenback from DEA are maybe three or four in number. I am not exactly certain on that. IRS and Customs are the primary contributors to the project.

Chairman Roth. Please proceed.

Mr. Egger. Recently we initiated a task force along with Customs to identify U.S. taxpayers who are using tax haven countries and offshore banks to evade taxes and to commit other related violations such as title 31. This task force is going to focus on the extent of noncompliance in this area and also focus on the schemes and some of the techniques that are being used. The information developed by this task force will be analyzed and disseminated to our field offices for investigative purposes.

The availability of these transaction reports and the Customs counterpart has been useful in providing limited paper trail but the Service has found it increasingly necessary in terms of the use of undercover agents in its investigation. We are finding that evidence secured in this manner which simply won't be otherwise obtained is proving to be fruitful in prosecuting some of these cases.

For example, in the Seattle-based operation involving an illegal tax shelter program where hundreds of individuals in several States were involved, five leaders were convicted of the conspiracy to cheat the Government out of millions of tax dollars. They attempted to do this by creating fraudulent deductions stemming from sham transactions between investors in foreign trusts which were set up in the British West Indies and Central America. A good deal of evidence in this case came from taped conversations which were recorded by our undercover agents in the investigation stage.

In a case which just became public, this past weekend five men were indicted for allegedly using a Las Vegas casino and foreign bank accounts to hide at least $16 million in illicit narcotic profits. The U.S. attorney involved called this probably the largest money laundering drug trafficking scheme in history.

Arrests were made in Las Vegas, Chicago, and Biloxi, Mississippi. Special agents of the IRS were intimately involved in this operation from its beginning and played a key role in bringing the case to its present status.

Mr. Chairman, passage of TEFRA also has been a great help to our criminal investigators. The criminal fines relating to Code sections 7201, 7203, 7206 and 7207 were increased by a substantial amount. New Code section 6867 now permits the presumption to be made where an individual is in possession of more than $10,000 in cash or cash equivalent and where he denies ownership but fails to identify anyone that can be identified as an owner. In this kind of a case the Service may presume that the cash represents a gross income of the individual for the year of possession and that collection is in jeopardy and take immediate action taxing it at the highest rate.

I might tell you that since the passage of TEFRA we have used this law at least four times.

Let me just conclude, Mr. Chairman, by saying that at times it must seem like the bad guys are winning, that is, in the running battle between promoters and users of offshore tax havens and the Government. Let me say this. From my perspective nothing could be further from the truth. I think I speak for other officials here when I tell you that we have absolutely no intention of losing this war. In fact, we are actively combating the problems posed by offshore tax havens and in the long run I am confident we are going to win.

We as part of the Treasury are examining ways in which we can work more closely with other agencies as well as with other bureaus of the Treasury and to make more effective use of the data that is being developed by these other agencies. One thing I would like to emphasize is the international nature of the problem and the corresponding need for a variety of actions to address it.

Of particular value are our initiatives in the area of simultaneous examinations and the international exchange of information. We have been working very closely with our treaty partners in other countries as well as other interested countries that do not have treaties with us. We think we are making real progress in the area and we certainly intend to keep on trying. We would be most happy to respond to your questions, Mr. Chairman.

[At this point, Senator Rudman entered the hearing room.]

Chairman ROTH. Is anyone else going to make any statement?

Mr. EGGER. No.

Chairman ROTH. Thank you, Mr. Egger.

It seems from your testimony that we have more of an acute problem than what I talked about. It appears we may have at least three and probably more aspects to the problem. But you mentioned the problem where you have a multinational organization with headquarters here selling through a tax haven to a third country, and the difficulties that arise there.

Let me ask you this: Where you have at least the headquarters here, aren't we in a better position than some of these other situations where we are dealing strictly with a corrupt organization or an individual taxpayer who is involved in tax avoidance? Is there anything we can do in the law to require the disclosure of information by the parent company that would help you get the information you need or are these essentially organizations that are corrupt and not complying with the law?

Mr. EGGER. I would ask Mr. Woodard to respond to that. But basically, Mr. Chairman, the problems we are having is that sometimes the information as to what happens after a transaction leaves the shores here such as in the illustration that I mentioned——

Chairman ROTH. If I understand that illustration, they were selling to a subsidiary abroad, in some cases I suppose there are many situations where that is not the case, but where they are selling to a subsidiary couldn't we require the disclosure of that kind of information or can you?

Mr. EGGER. The problem is that the sale ostensibly is to the tax haven subsidary and then the laws of the tax haven country prohibit frequently the disclosure of information. Let me ask Mr. Woodard to respond to that.

Mr. WOODARD. In the example we use we show a foreign parent which gives more difficulty than a situation where we have a U.S. company operation with the subsidiary overseas. In this particular example the U.S. company which is a subsidiary of a foreign parent has no direct ownership of either of the other two subsidiaries. So under these circumstances our current information report requirements do not reach.

However, in a large number of transactions where we are dealing with U.S. companies, let's assume this was a U.S. parent, our current information and reporting requirements do require that information be furnished to us with respect to controlled foreign corporations.

Chairman ROTH. That is what I thought.

Mr. Woodard. We have recently revised our reporting mechanism to incorporate five previous forms into one new form which is available to taxpayers this month.

We think that will simplify the reporting requirements and get the information to us in a much more useful and usable form.

Chairman Roth. Let me ask you a different question.

In these tax haven countries, how much of the money goes into local banks or these cottage industry banks that are set up for illicit purposes? And how much flows through branches of multinational banks that are recognized as responsible organizations, American or otherwise?

Mr. Egger. I am not sure we have any accurate statistics in that respect, Mr. Chairman.

Mr. Wassenaar may have something more on it than that.

Chairman Roth. Could I ask you this: Where it goes through a branch or subsidiary, again, are we in a better position to get that information?

Mr. Egger. I think in most cases we can require it if it is a foreign branch of the U.S. bank. Yes, sir. I am satisfied that if present regulations do not do so that in most cases the Bank Secrecy Act authority would permit requiring that. I think later on the Treasury witnesses may be in a better position to answer that question.

Chairman Roth. I will withhold, then.

One of the problems, it seems to me, in this area is that as we put pressure to get results on one haven center, it creates an opportunity elsewhere.

A recent article indicates that since November 1982 some 2,000 westerners had deposited more than $30 million in Hungarian bank accounts.

This money is supposedly leaving Switzerland. I wonder, how much of a problem is there with money going behind the Iron Curtain?

Mr. Wassenaar. Again, Mr. Chairman, I am not certain we have an accurate figure.

Chairman Roth. I know that you are dealing in the realm of speculation. But do we have any information, any intelligence as to whether this is a growing problem or a significant problem or what?

Mr. Wassenaar. Although we have had some investigations involving countries behind the Iron Curtain, we are not talking about a sizable number of investigations. Right now we do have an investigation in process involving the U.S.S.R. There may be two or three other Communist-type countries that are involved where we have a need to have a productive investigative inquiry behind the Iron Curtain.

Chairman Roth. Both the Washington Post and the USA Today recently had articles, I think it was within the last couple of weeks, pointing out the increased use by IRS of undercover operations and other sophisticated investigative techniques to penetrate large tax shelters and the tax fraud schemes hiding behind haven secrecy laws.

Can you tell us why these extraordinary procedures are necessary and give us examples of cases that might not have been or could not have been successfully prosecuted without them?

Mr. Egger. Let me respond briefly and then ask Mr. Wassenaar to elaborate. To a very, very large extent, some of the tax shelter schemes that we see on the face of the documents appeared to be one thing, but the private negotiations which go on by word of mouth and even by under the table type documentation make the scheme clearly illegal. In other words, what may purport on its face to be a perfectly legitimate debt obligation is eliminated by either a promise or by even documentation which is just handed to the individual and which never sees the light of day in the normal investigation.

Those are simply examples. We do not carry out these undercover operations until we have a pretty clear indication that there is something more to be learned that we haven't been able to learn in the standard type of investigation. Invariably these are the cases.

So either promoters of fraudulent shelter schemes or we have used that kind of technique in the narcotics trafficking cases and money laundering cases.

Mr. WASSENAAR. Mr. Chairman, first of all, let me make a comment that I think our criminal investigators are probably about the best in the world in terms of following the flow of money. Second to none.

In large part we are able to trace the flow of money because, frequently, especially if it stays within the bounds of this country, it leaves a paper trail.

We can follow it as long as it leaves a paper trail. When that money goes offshore in a tax-haven country or a country that has a bank secrecy, that paper trail stops. It is virtually impossible to continue to trace it once it runs up against the veil of secrecy.

In situations like that, I think it is almost essential that we be able to use other investigative tools like undercover in hopes of, first of all, identifying the flow of this illegal money offshore.

Having identified it, again I think it is almost essential that we have something like undercover or some other investigative technique that enables us to get the necessary evidence to prove the criminality or the falsity of the transaction involved.

I guess the classic example of a case where we used undercover quite successfully and I might say but for undercover we would not have obtained the conviction is the Commissioner's first example where he talked about the creation of multiple foreign trusts.

That particular case involved five defendants who were found guilty in Seattle, Wash., involving estimates of about $83 million in improper deductions claimed by individuals who had invested in these particular schemes.

We, too, invested in one of those schemes in an undercover capacity and as a result of our investigation, our conversations with the individual promoters of this scheme, we were able to present to the court on recorded tape sufficient testimony for them to find a guilty verdict relative to the conspiracy.

I might refer to a Seattle Times article that appeared on January 30, 1981 where the reporter was talking to the jury foreman. The jury foreman was relating to the reporter that for 2 or 3 days in the jury deliberations, the jury was deadlocked on the conspiracy charge. They, then, asked the court to rehear the undercover tapes. Then the jury foreman said, "There were a lot of things on that tape that changed a lot of jurors' minds. It had a lot to do with the conspiracy charge."

So I submit to you that except for having that undercover tape, producing that kind of testimony before the courts, this very complex scheme mentioned earlier by the Commissioner involving $83 million and five promoters probably would not have resulted in the successful conviction that we obtained.

Chairman ROTH. We have had some testimony with respect to negotiating agreements with Switzerland and other countries on a bilateral basis on disclosure, and making exceptions to their secrecy provisions.

That is sort of, I guess, what I would call a passive cooperation.

Has any effort been made to reach agreement with other countries, with respect to cooperation in these areas?

Many of these fraudulent schemes cross international lines. I suppose they impact on other governments as well as ours.

Are we seeking to jointly investigate any of these international matters that involve other countries or is that on a case-by-case basis?

Mr. EGGER. We have a series of programs which do not necessarily take the form of a bilateral assistance agreement which the Justice Department is pursuing as our witnesses indicated.

The other part of it, of course, is the Treasury's own treaty negotiating—that is, tax treaty negotiating—in an effort to include in those treaties the exchange of information.

Principally, in those countries where we have tax treaties we pursue a rather constant exchange of information both in terms of specific taxpayer information and in terms of general information which is given to us by our tax treaty partners and we in turn provide them with similar type information.

More importantly, perhaps from the standpoint of criminal investigations, our participations in international investigative groups such as Interpol and then, of course, we have on a number of occasions participated in informal gatherings, meetings with representatives of other countries with respect to getting exchange of information.

You may wish to comment on some of the things that we have done with Colombia, for example.

Mr. WASSENAAR. Let me comment, first, on the mutual assistance treaty problem as it relates at least from an IRS perspective. I think the problem with mutual assistance treaties as it relates to IRS is the fact that in most of the countries we are talking about, tax evasion is not a crime. So it might be difficult for us to negotiate with those countries.

Chairman ROTH. That would be a popular political concept.

Mr. WASSENAAR. I think it might be substantially easier, of course, when we are talking about narcotics. But IRS doesn't have to be in that business, say, except to the extent that it might involve tax evasion. But the problem, I guess, with negotiating with a foreign country for a more acceptable mutual assistance treaty probably won't go too far if you talk about true tax evasion cases or the need for information as it relates to tax evasion cases.

Mr. EGGER. We may be headed down that road because of the developing relations with countries around the world. I participated in an activity in South Central America which was called the Center for InterAmerican Tax Administrators, and this is a group made up of about 25 nations in the Central and South American area, and for the last 2 years we got together both in terms of the working groups and in terms of an annual meeting of the senior tax administrators.

The whole subject of tax compliance and tax avoidance, tax evasion has been the principal discussion. We are doing the same thing with other meetings. We have an annual meeting with four Western European countries and with countries in the Pacific and those subjects are constantly growing in importance and other countries willingness to work with us in the exchange of information is ever so much better today than it was 10 years ago.

Chairman ROTH. It seems to me that until we reach some kind of broad cooperation between various regions of the world that this is a problem that is extraordinarily difficult to aggressively or effectively attack.

With more and more people traveling, with the problems of sophisticated communications, it is just up to man's imagination to devise new ways and means of avoiding or evading taxes.

Mr. EGGER. I would agree with you. You are absolutely correct. It is a growing problem, but a growing problem not just for the United States, but for other countries as well.

I think that is the key.

Chairman ROTH. Yes; that is the point I am making. This is not a phenomenon peculiar just to us. All countries depend on taxation of one kind or another, I suppose. Maybe a progressive income tax would make it more virulent in this country.

I don't know. But I guess it seems to me it is incumbent upon this country to begin to actively seek some kind of international agreements or cooperation if we are really going to succeed.

Let me ask you one final, two part question and then I will turn it over to Senator Rudman. There is the growing perception in this country that more and more people are avoiding paying their fair share. This feeds upon itself. If you are not paying your fair share; why should I?

To what extent do we see John Q citizen beginning to take advantage of trying to get funds overseas for purely tax evasion purposes?

How widespread a problem is this?

One of the things that particularly concerns me, is that we see more and more evidence that this is becoming a very acute problem. For example, a Chicago Tribune newspaper article, dated Feb. 16, 1983, noted the tragic loss of two U.S. Marshals who were killed while trying to arrest a member of the posse comitatus.

[The newspaper article referred to follows:]

[From the Chicago Tribune, Feb. 16, 1983]

"TAX FANATIC" HUNTED ON NORTH DAKOTA FARM

HEATON, N.D—Police backed up by a National Guard armored personnel carrier surrounded a fog-shrouded prairie farm Tuesday where a "fanatic" tax protester suspected of killing two U.S. marshals was believed to be holed up.

"I'm not going to let them take me again," Gordon Kahl, 63, had told a neighbor shortly before he got into a shootout with U.S. marshals who tried to arrest him Sunday for violating probation imposed in a 1977 tax evasion case.

Another man suspected in the slayings, Scott Faul, 29, of Harvey, was arrested Monday night in nearby Fessenden, N.D., said U.S. Attorney Rodney Webb. Faul was believed to be in the car with Kahl at the time of the shooting. Four other people had been arrested earlier.

FBI agents, sheriff's deputies and police officers late Monday began searching the 320-acre farm where Kahl used to live and his son now lives. But darkness and fog prevented them from getting as far as the house, according to Dick Hickman, a Crime Bureau agent from Williston.

Neighbors said Kahl had been known to carry a gun.

"But I wasn't afraid of him," said one man, who would not give his name. "He was a good neighbor and helped us tune up our equipment. I just wouldn't talk to him about the other things. If you just said one word about things like taxes, he was off."

Kahl is "one of those income tax fanatics," said U.S. Deputy Marshal Ordean Lee.

The search for Kahl focused on the farm when authorities spotted tracks leading out of a grove of trees across the road. They followed the tracks to a car which authorities said had been stolen at the shooting scene Sunday.

Two marshals were killed, one was wounded critically and two police officers suffered less serious wounds when they attempted to arrest Kahl near Medina, about 50 miles south of Heaton. Authorities said occupants of a car opened fire with an automatic weapon as the officers approached.

Kahl's wife, Joan, 62, and his son, Yori, 23, were arrested Sunday at a Jamestown hospital where Yori Kahl was being treated for gunshot wounds. Yori had been living at the farm which authorities staked out.

On Monday, authorities arrested David R. Broer, 53, and Vernon A. Wegner, 25, both of Streeter, who were said to have been in another car with Kahl's wife and son.

In Carrington, 20 miles east of Heaton, people recalled him as having changed in recent years.

"He was a nice person, but later on in the years I knew him he got awfully goofy," said one Carrington merchant.

"About 10 years ago, it was the Mormon Church. It got to be a big thing with him and we don't even have any Mormons around here. Then it was the Jews. He was talking about how the Jews were going to take over," said the businessman, who did not want his name used.

Chairman ROTH. I am very concerned that we have uncovered evidence during this investigation of tax protestors using secret bank accounts to hide their income and have received allegations that this group is becoming more and more radical in their approach.

Would you comment on that?

Mr. EGGER. I certainly will. It is of the utmost concern to me and to us in the Internal Revenue Service, because we see on a day-to-day basis the growing militancy with which certain groups, particularly in some of the Western, Midwestern States are resisting any payment or collection of tax liability.

They take the position, No. 1, that they are not required to pay tax and then when we pursue that by preparing the return ourselves, then assessing the tax, then the collection of it becomes a point of confrontation.

We have had to take, over the recent year or two, rather extreme measures to both train our collection people, our revenue officers and the special agents in ways of avoiding the kind of confrontations that could possibly mean their lives and seeing to it that they know how to deal with those situations when they arise.

It is clear that there is more of this today than there was a few years ago. It is also clear that the convenience of some of the tax havens in off-shore banking facilities makes it easier for them to hide not only the income but take funds out of our jurisdiction for the purpose of, again, stymieing us in the collection.

You may wish to comment on it. This is his business. This is the day-to-day problem he lives with.

Mr. **Wassenaar.** Mr. Chairman, I think it was about 3 years ago that we first discovered that illegal tax protestors were making use of foreign tax havens in attempts to evade taxes.

Over the past few years we have conducted investigations and are conducting investigations in approximately 500 cases involving foreign tax havens. Of that 500, some 35 cases involve investigations of illegal tax protestors who have had some activity involving foreign tax havens.

We are seeing an increase in numbers.

Chairman **Roth.** Senator Rudman?

Senator **Rudman.** Thank you, Mr. Chairman.

I have another meeting about now. So I really have only one question. I couldn't help but thinking about the chairman's first question about 2,000-plus westerners depositing $30 million-plus in a Hungarian bank, I assume, to receive interest.

I think those are the only banks I haven't heard from about the 10-percent withholding.

I assume that the Hungarian banks are not going to withhold the 10 percent.

If you can pull that one off, Commissioner, you will have done a very good job.

I really have only one question. It relates to the Bank Secrecy Act.

Is that a deterrent in itself, the requirements of that act?

Mr. **Egger.** Yes. The Bank Secrecy Act currently requires that banks file with us a so-called currency transaction report. All currency transactions in excess of $10,000 and it is through those reports that we both identify and initiate a number of our investigations.

Senator **Rudman.** Is that cash and wire transfer both?

Mr. **Egger.** That is currency only.

Senator **Rudman.** What about wire transfer?

Mr. **Egger.** The wire transfers, we haven't dealt with specifically. That is one of the areas that we and the Treasury will be looking into.

Senator **Rudman.** The reason, Commissioner, I raise the question is, in the work I did before coming here that Senator Roth referred to, I knew of several cases in which we were tracing money and, of course, we were dealing with fairly small slices of it. But there was some substantial fraud involved and we found that inevitably the perpetrators of the fraud, unless they were planning to set up residences in Europe, South America, or the islands and acquire capital assets there, they wanted to bring that money back to the United States. They could set it up as long as they wanted to set it up, they could get all kinds of tax deferrals, but eventually they had to bring that money back.

It was a very successful scheme. The money came back through wire transfers to a New Hampshire bank. It seems to me that with the technology we have available to us and particularly since it is my understanding that most of these wire transfers eventually come through a few clearinghouses, there ought to be a way to develop legislation and then operational technology that will in fact identify these substantial foreign transfers coming back into this country.

Once you were able to identify that, there are a number of methods well known to you to ascertain whether that money is legitimate or not. I am sure you know those better than I do. I am very familiar with some of the methods.

Realizing that it may be a month of Sundays or 10 years of Sundays before we ever get the kind of cooperation from these foreign countries, island empires, et cetera, that we would like to work with but who won't work with us for reasons of incentive, why don't we concentrate on beefing up our own tracking within America of the wire transfers coming back into this country, and develop a method to screen them out.

If we could do that, I believe you could be a lot more successful in preventing the kind of things you and the chairman were speaking about a moment ago.

Mr. **Egger**. Your point is certainly well taken. Currently we can get information from the banks in connection with the specific investigation.

To the best of my knowledge, there is no requirement for the banks to report routinely on major wire transfers. It is one of the areas that we are looking into in the Treasury to determine whether it takes legislation to get at some of that information or whether it is something that can be done under existing legislation.

Then, second, we are going to have to take a look at the burden it puts on the banks.

As you know, the withholding of the 10 percent is posing according to some reports at least a significant burden and I am not sure reporting of wire transfers would be on top of that.

Senator **Rudman**. I wonder who would get these little post cards next. Maybe it would be organized crime that would be sending these cards to us.

Let me say to you that if you in fact would look into that particular subject for us and get back to us, back to our staff, it seems to me that this Congress would be probably pretty willing to give you some authority in the area of tracking foreign wire transfers back into this country at which point, you would simply match them up in the computers.

For instance, if you found on my tax return with a little computer that told you I got $165,000 in wire transfer in 1982, I expect you would want to look at my return and talk to me.

Right now, you don't. I just think that this subcommittee would be very interested in hearing a proposal from you as to how we could strengthen our authority. At least, if we cannot get them from the foreign banks, let's see if we can get it from the U.S. banks, particularly those countries that we have problems with.

I wish I could discuss it more. That is my feeling on the matter. I think that is one way to get to it rather quickly.

I am not too worried about whether the banks like it or not. I think we are losing an awful lot of revenue. I think there ought to be a way to deal with it.

Mr. **Egger**. I would be glad to.

Senator **Rudman**. Thank you. Thank you, Mr. Chairman.

Chairman **Roth**. Thank you, Senator Rudman.

Gentlemen, I appreciate your being here today.

If there are any more questions, we will submit them in writing.

At this time I would like to call forward Mr. John Walker, Assistant Secretary, Enforcement, Department of Treasury and Alan Granwell, International Tax Counsel.

If you would remain standing and raise your right hands, do you swear the testimony you will give before the subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. POWIS. I do.

Mr. GRANWELL. I do.

Mr. WALKER. I do.

Chairman ROTH. Please be seated.

I would ask that each of you who are testifying or have an opening statement, summarizing it. The full statement will be incorporated into the record.

Mr. Walker.

TESTIMONY OF HON. JOHN M. WALKER, JR., ASSISTANT SECRETARY, ENFORCEMENT, DEPARTMENT OF TREASURY; ALAN W. GRANWELL, INTERNATIONAL TAX COUNSEL, DEPARTMENT OF TREASURY; AND ROBERT D. POWIS, DEPUTY FOR ENFORCEMENT, DEPARTMENT OF TREASURY

Mr. WALKER. Thank you very much. On my left I have my Deputy for Enforcement, Robert D. Powis, who is also available in case the subcommittee has any particular questions. I am submitting my prepared statement for the record,[1] and will present a summary of that statement.

Mr. Chairman, members of the subcommittee, thank you for the opportunity to present our views on the problems raised by the use of foreign corporations and financial institutions to facilitate violations of U.S. law and also some possible counter measures. Our interest in this subject flows primarily from the interests and functions of two Treasury law enforcement agencies, IRS and Customs, to protect the revenue and our national economic interests. But in addition, since the passage of the Bank Secrecy Act in 1975, we have had a special responsibility with respect to transnational investigations.

At this point, Mr. Chairman, I would like to underscore the importance that we attach to financial investigations in Treasury, particularly as they relate to drug trafficking or organizations which operate internationally. Through these investigations, we are able to reach the top people in drug trafficking cartels, people who never themselves handle the drugs. Moreover, where the financial trail leads to a person who does handle the narcotics, the case against them is vastly improved for a jury in a criminal case understands the accumulation of vast wealth as much as trading in drugs.

Finally, these investigations enable us in law enforcement to identify pools of assets for seizure and forfeiture and use this to deprive the criminal not only of his ill-gotten gains but also the capital base for his unlawful enterprises.

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[1] See p. 278 for the prepared statement of Hon. John M. Walker, Jr.

Our principal weapon in conducting these financial investigations lies in the recordkeeping and reporting requirements of the Bank Secrecy Act, which is administered out of the Office of the Assistant Secretary for Enforcement and Operations. When the Bank Secrecy Act was introduced by the chairmen of the Senate and House Banking Committees, it was clear that they intended the Bank Secrecy Act to play a major role in combating the use of foreign bank accounts to facilitate violations of U.S. laws. During the hearings that preceded the passage of the Bank Secrecy Act, officials from several Government agencies testified concerning the need for assistance in identifying suspicious transactions and movements of currency in documenting international transactions in general. The act was intended to assist law enforcement officials by providing for the retention of records of all significant international transactions as well as reports of unusual domestic currency transactions, the international transportation of currency and other monetary instruments, and reports of international transactions or accounts.

It is the linchpin for all investigations of financial activities. And it was specifically designed to deter transnational crimes.

The reporting requirements of the Bank Secrecy Act provide a unique way to follow unusual cash flows including cash flows caused by major drug traffickers and the money launderers. Indeed the tracking of cash flows through the reporting requirements of the act frequently leads to the identification of drug trafficking organizations. As an added bonus, the Bank Secrecy Act provides criminal sanctions to those who fail to comply with its requirements. The major narcotics trafficker who carefully insulates himself from actually handling drugs, can still be brought before the bar of Justice for failure to comply with reporting requirements in the Bank Secrecy Act or for income tax violations, even though we may not be able to prove the underlying narcotics offenses.

Under the act, Mr. Chairman, and the regulations that have been promulgated pursuant to it, financial institutions are required to report to the IRS unusual currency transactions in excess of $10,000 on IRS form 4789. In addition, then international transportation of currency and certain other monetary instruments in excess of $5,000 generally are required to be reported to the Customs Service, on customs form 4790; and U.S. persons are required to report foreign financial acts, certain records of such act are required to be maintained in the United States. The regulations were designed to provide an integrated system for tracing and documenting the overwhelming majority of financial transactions that might be of interest to investigators.

Financial institutions are required to maintain records of checks, wire transfers and other movements of funds and be able to reconstruct transaction accounts. The currency transaction reports and reports of the international movement of monetary instruments are intended to fill the gaps in the system resulting from the use of currency and bearer instruments. In addition, the reports are also intended to alert the law enforcement community to specific activity that appears to warrant investigation.

In 1980, we realized from our review of compliance in Florida that the regulations pertaining to the currency transaction reports needed to be tightened up. Some banks had been exempting individuals with Latin American addresses from the currency transaction reporting requirements simply because those persons brought amounts of currency into the bank on a regular basis. Unfortunately, too often these customers also happen to be suspected drug traffickers. In addition, some banks frequently accept shopping bags or boxes of currency from couriers whose identity they do not bother to verify.

The regulations were amended in 1980 to limit a bank's authority to exempt currency transactions from the reporting requirements. Only deposits and withdrawals by an established depositor who is a U.S. resident and operates a retail business in the United States can be exempted without the approval of the Treasury Department. More specific identification requirements were also provided. Financial institutions are now required to verify the identity of persons who conduct reportable currency transactions with them. The identity of aliens who are not U.S. residents must be made by passport or some other official document. While these changes have created an additional burden for banks, there is no doubt in my mind that they are justified.

Working with the IRS, Customs, and bank supervisory agencies we have taken several other actions to improve filing compliance and the quality of the currency transaction report data base.

Obviously as the quality of the data base improves, the more useful it will become not only for the individual investigations, but for analytical reports. For example, we have found that analysis of the volume of currency transactions between U.S. banks and foreign persons or institutions is very valuable in indicating areas where additional investigative actions should be taken.

I would like to turn briefly to Operation Greenback in Florida as an example of some of the value of this kind of material.

In 1980, Treasury's Office of Enforcement and Operations, with the cooperation of the IRS, Customs, and the Department of Justice, developed Operation Greenback. It is an integrated investigation of the huge surplus of currency in the Federal Reserve banks in Florida, which we believe results, in part, from illegal activity. The surplus grew from $1.5 billion in 1976 to a peak of $5.8 billion in 1980. In 1982, it declined to $5.3 billion. Operation Greenback was based primarily on two concepts. First, an attack on the illegal activity associated with the currency could be made through the financial operations of the violators. Tax laws and the reporting and recordkeeping requirements of the Bank Secrecy Act could be effectively employed in this effort. Second, the criminal investigation should be integrated through the use of the grand jury process, Federal prosecutors coordinating all of the related investigations.

Since the inquiry is being conducted under the authority of the Grand Jury, all of the Federal agents participating in it can pool information including tax or other financial information. This kind of sharing, which streamlines the investigative process, is not permitted under the procedures governing the administrative inquiries.

Operation Greenback has documented $2,065 million in U.S. currency that has been laundered through international transactions by seven different organizations. During the 30 months of operation ending December 31, 1982, Treasury has seized more than $28 million in currency. In addition, property in excess of $2.5 million has been seized. Appearance bonds in excess of $1.8 million have been forfeited and jeopardy tax assessments totaling more than $112 million have been made. There are approximately 40 special agents from IRS and Customs assigned to Operation Greenback.

Through the combined effort of the IRS and U.S. Customs Service, there have been approximately 140 indictments and 44 convictions to date and approximately 90 cases are pending trial.

Although Operation Greenback cases tend to overshadow other cases, a large number of significant Bank Secrecy Act investigations have been undertaken in many cities across the country. More than 20 financial investigative task forces have been established throughout the United States and Puerto Rico. They are modeled after Operation Greenback. Several of the investigations involve international transactions or foreign financial institutions.

Mr. Chairman, I now would like to present what we believe is a need to amend the Bank Secrecy Act and its regulations.

Mr. Chairman, as I have recited in this statement, massive effort has been made to insure that the records needed to trace financial transactions in banks in this country are available to law enforcement for law enforcement purposes. To the best of my knowledge, that effort has been very successful. Transactions that occur in this country can be documented. In addition, Customs, IRS and other Federal supervisory agencies are expending a great amount of time in obtaining compliance with the reporting requirements and in analyzing the report data. However, in spite of our successes, there is abundant evidence that much more needs to be done. Information available to us indicates that hundreds of millions of dollars in cash is being transported out of the country without filing the required currency and monetary transaction report. Foreign banks and corporations continue to be used to thwart our efforts to enforce the law. In my opinion, much of the weakness in the system could be overcome by making the following changes in the Bank Secrecy Act.

First, amend section 5316 of title 31, by making it a crime to "attempt to transport or cause to be transported" monetary instruments in excess of $10,000 without filing a report with the Treasury. That is a customs report. Mr. Chairman, the present law does not make it a crime to attempt to transport. Therefore we have a situation where the person is carrying a monetary instrument onto an airplane without reporting it, the crime is not committed until he is actually transported out of the country. At that time it may be a little difficult to apprehend the individual. The attempt provision would take care of that.

Second, amend section 5317 of title 31 by authorizing customs officers to stop and search a vehicle, vessel, aircraft or other conveyance including an envelope or other container or any person entering or departing the United States if there is reasonable cause to believe that there is a violation of the reporting requirements. At the present time there is no expressed statutory authority to cover outbound export-type investigations.

Finally, add a new section authorizing the Secretary of the Treasury to pay rewards, except to certain Federal, State, and local officers, for original information leading to the recovery of a fine, penalty or forfeiture exceeding $50,000.

Mr. Chairman, furthermore I believe that the information that we have received from the investigative efforts in Florida and the analysis of financial data indicates that we also need to take actions to strengthen our Treasury regulations. We are going to draft amendments to the Bank Secrecy Act regulations that would require currency exchanges and the dealers in foreign exchange to maintain adequate records of their transactions. These institutions have played a major role in laundering money in Florida and other States. They function like a bank in many respects and should be subject to the same type of recordkeeping provisions as banks.

In addition, it appears that the time has come to expand further the utilization of the Treasury Department's authority to require reports of foreign financial transactions. There have been many statements regarding the need for law enforcement agencies to be alerted to unusual international movement of funds by cashier's check, wire transfer or other methods.

Although the Bank Secrecy Act would authorize a regulation requiring that such transactions be reported to the Treasury Department, we have been cautious about issuing such a regulation. There are, as we all know, too many international transactions that are legitimate to warrant a shotgun solution to the problem. Nevertheless, it is increasingly clear that law enforcement officials need assistance in identifying those persons who are using foreign financial facilities to further their criminal activities.

In my opinion, a reasonable approach to the problem would be for the Treasury Department, on the basis of information indicating that there has been a probable misuse of foreign financial facilities by U.S. persons to impose selective reporting. For example, if there is reason to believe that banks in a foreign country are being utilized to further illegal activity, the Secretary would require specific classes of persons or domestic financial institutions to report their transactions with those foreign banks.

We believe that such a requirement would be extremely useful to the IRS in tax enforcement as well as to the other Federal agencies interested in transnational crime.

Mr. Chairman, I would appreciate it if the subcommittee would consider and support these proposals. I believe that they would be major contributions to our efforts to overcome the use of foreign banks to conceal illegal activity.

Mr. Chairman, I would be happy to answer any questions that the subcommittee might have.

Chairman ROTH. The subcommittee will have to be in recess temporarily, because we have a vote on the Senate floor. I will return promptly at which time we will proceed.

[Senator present at the time of recess: Senator Roth.]

[Senator present at the time of commencement: Senator Roth.]

Chairman ROTH. The subcommittee will please be in order.

Mr. Granwell, I believe you have a statement. We are very pleased to have you here. I would ask if you could, to summarize your statement.

Mr. GRANWELL. Thank you, Mr. Chairman.

I am pleased to appear before you today to provide an overview of some of the initiatives of our tax treaty program to prevent the avoidance and evasion of U.S. income taxes.

Pursuant to your request, I will summarize my statement and submit the whole statement for the record.[1]

As background to my discussion, it may be useful to review briefly the purpose of income tax treaties. There are two primary purposes of bilateral income tax treaties: to mitigate double taxation of income and to provide mutual assistance in combating tax avoidance and evasion.

With respect to mitigation of the double taxation, income tax treaties provide taxing jurisdiction between the two countries that are parties to the tax treaty. In the normal treaty relationship, there are flows of income in both directions. Therefore, each country will assert all or a portion of its rights to tax certain income from sources in its country and each country will provide relief with respect to income of its residents from sources within other countries. In that regard income tax treaties generally provide for reduced rates of tax on investment income by the host country so that the aggregate tax burden of the investor will not exceed that which he would pay if he had invested in his home country.

With respect to exchange of information, tax treaties provide elaborate mechanisms for each contracting state to, among other things, obtain tax-related information with respect to their residents and other taxpayers and to consult with the tax authorities of the other states on measures to prevent the avoidance and evasion of taxes.

One treaty abuse that the United States is trying to control is treaty shopping. Treaty shopping, in essence, is the ability of residents of countries other than the countries that are parties to the treaty to derive treaty benefits such as rate reductions on passive income by channeling investments through entities organized in or resident in a treaty jurisdiction. Treaty shopping results in tax avoidance because treaty benefits are obtained by unintended beneficiaries. This weakens our ability to expand our treaty network and to successfully renegotiate beneficial provisions to our existing treaties. Thus, if residents of countries with which the United States has no treaty can avail themselves of U.S. treaty benefits, their countries of residence may have little incentive to enter into treaties with the United States.

Similarly, if residents of countries which have a tax treaty with the United States can obtain greater benefits by treaty shopping in cases where U.S. residents can not obtain reciprocal benefits, their countries of residence are under little or no pressure to renegotiate their treaties to address U.S. concerns. It is the established U.S. tax treaty policy to include a "limitation of benefits" article to prevent treaty shopping. These provisions act to, among other things, deny treaty benefits in appropriate circumstances and thereby permit the United States to impose its full statutory rate of tax on payments to such entities. Limitation of benefits provisions will be employed wherever necessary and in the form appropriate to the circumstances to ensure that U.S. policy goals are served by the extension of benefits in our tax treaties.

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[1] See p. 291 for the prepared statement of Alan W. Granwell.

Under present law, a recipient of U.S. source dividends who has an address in a country with which the United States has a tax treaty that provides for a rate reduction with respect to such income will be presumed to be a resident of such country for purpose of obtaining reduced rates of tax on such dividend. With respect to interest and other types of passive income, a foreign taxpayer may obtain a rate reduction by certifying his eligibility for treaty benefits to the withholding agent. Both of these methods of obtaining reduced rates of tax under a treaty are subject to abuse.

The address system of withholding the tax on U.S. source dividends is particularly vulnerable since such system permits tax evasion by persons who are not legitimate treaty beneficiaries but who merely establish post office boxes or nominee accounts in countries with which we have a tax treaty providing for reduced rates of tax on dividends. The only real check on this abuse is provided by certain of our treaty partners who collect and remit additional taxes to the United States if they determine that a particular dividend recipient is not a bona fide treaty beneficiary. However, much abuse goes undiscovered and even with respect to amounts remitted by our treaty partners substantial costs in terms of delay and uncollected interest inevitably occur.

The self-certification procedure which applies to interest and other types of passive income is similarly subject to abuse in that it requires a person claiming treaty benefits merely to submit an unverified self-serving statement to a withholding agent who is entitled to rely on such statement for purposes of reducing the amount of tax withheld. The Treasury Department detailed its concerns with respect to these procedures in testimony at hearings held on June 10, 1982, before the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Government Operations Committee.

Section 342 of the Tax Equity and Fiscal Responsibility Act of 1982 was enacted in response to the concerns raised at the 1982 hearings. Section 342 directs that procedures be designed which will prevent the kind of abuse that occurs through the improper use of nominees and other conduits that pass U.S. source income through to a person who is not a bona fide resident of the treaty country.

A number of alternatives to the present enforcement systems exist, including the adoption of a refund system of withholding tax on passive income. A refund system would require withholding agents to withhold U.S. tax at the statutory 30-percent rate on all U.S. source passive income, regardless of the potential application of a treaty provision reducing the 30-percent rate or eliminating the tax altogether. The foreign recipient who claims treaty benefits would then be required to file a claim refund. An annual tax return and supporting documentation would be required.

Another approach, a certification system, would require the foreign recipient to file a certificate of residence with the competent authority of the country whose treaty benefits are being sought. Pursuant to the mandate of section 342, we are presently considering such stricter procedures.

It is an established principle of international law that a country is not obliged to assist in the enforcement of the penal or tax laws of another country in the absence of an applicable treaty or bilateral agreement. Different types of international agreements may be used by the United States as the basis for obtaining information about foreign activities of U.S. taxpayers including bilateral income tax treaties, bilateral mutual assistance treaties and exchange of information agreements.

With respect to tax treaty exchanges of information, each of our income tax treaties contains a provision requiring the exchange of tax information. The scope of these provisions varies considerably. However, our 1981 draft model income tax treaty, which serves as our opening position in treaty negotiations, contains very broad information exchange provisions. It extends to any information necessary for carrying out the provisions of the treaty or the domestic laws of the contracting states concerning taxes covered by the treaty insofar as the taxation thereunder is not contrary to the treaty.

The 1981 model also provides that, for purposes of information exchange, the taxes covered by the treaty are deemed to be all taxes imposed by a contracting state at the national level, thereby including taxes other than income taxes covered by the treaty. The broader definition of the 1981 model has been included in many of our recently ratified treaties. Because exchange of information provisions cannot be totally expansive, the 1981 model includes certain limitations on the obligations of the party to gather or exchange information. There are provisions expressly limiting obtainable information to that available under the laws of the requested state. The information exchange provisions in the 1981 model also contain limitations on the use of information exchange. Information exchange must be subject to the same taxpayer protections of secrecy as tax information normally received by the requesting state. The information may, in any event, only be disclosed to persons involved in the assessment, collection or administration of the tax laws of the other country. In that regard, Treasury has made special efforts to insure access by the GAO of information received under tax treaties. The 1981 model also provides that information may be disclosed in open public proceedings.

The United States generally engages in three methods of information exchange under current tax treaty provisions: Routine or automatic exchanges consisting primarily of exchange of names of taxpayers and the amount of passive income they received from sources within the other contracting state; exchange of information on specific request of one of the contracting states; and spontaneous exchanges of information transmitted at the discretion of the transmitting country when information comes to its attention which suggests or otherwise establishes noncompliance with the tax laws of the other contracting state.

In addition, as Commissioner Egger has indicated, the Internal Revenue Service has executed simultaneous examination agreements with treaty partners. These agreements provide for simultaneous examinations of multinational corporations in carefully selected cases. Generally these examinations are of multinational corporations engaged in tax haven operations. The program has been successful with the consequence that the IRS is in the process of extending it to other treaty partners.

So too, the IRS has also undertaken industrywide exchange of information with treaty partners. The objective of these exchanges is to secure comprehensive data on worldwide industry practices in such industries as oil and gas and pharmaceuticals. The United States is continually striving to develop new and improved methods to cooperate on information exchange with our treaty partners to combat international tax evasion.

With respect to mutual assistance treaties, this has been summarized in prior testimony by my colleagues of the Justice Department. So too, have the exchange of information agreements in the Caribbean Basin Initiative. I will, however, summarize what the effect is of the CBI provisions.

There are countries which do not have an income tax treaty with the United States, either because agreement on terms is not possible or because they do not have income taxes, but with whom it may be possible, in certain circumstances, to negotiate a more limited agreement to exchange information. This approach has been proposed in the Caribbean Basin Initiative legislation, which requires an exchange of information agreement relating to both civil and criminal matters as a precondition to the extention of certain U.S. tax benefits relating to tax deductions for expenses incurred attending conventions held in qualifying CBI countries.

In conclusion, Mr. Chairman, the approaches I have described are an important part of the initiatives undertaken by the United States to combat international tax avoidance and evasion. I thank you, Mr. Chairman and members of the subcommittee for your interest in the matters which we have addressed today and I am pleased to have the opportunity to consider these important issues with you.

I would be happy to entertain any questions you may have at this time.

Chairman ROTH. Gentlemen, I want to express my appreciation to all of you for your cooperation and help. It is very appreciated by this subcommittee.

Mr. Walker, in your prepared testimony, I think you make a very interesting suggestion about selectivity. One of my concerns is that the problem is so broad, so pervasive, that probably it is not practical to provide adequate law enforcement personnel and facilities to cover the entire range.

Somehow we have to devise means of selecting those areas that are most serious.

On page 12, you raise the possibility that we should have selective reporting. You say there:

> In my opinion, a reasonable approach to the problem would be for the Treasury Department, on the basis of information indicating that there has been a probable misuse of foreign financial facilities by U.S. persons, to impose selective reporting.
>
> For example, if there is reason to believe that banks in a foreign country are being utilized to further illegal activity, the Secretary could require specific classes of persons or domestic financial institutions to report their transactions with these banks.

I wonder if you would care to comment, Mr. Walker, about this approach.

Mr. WALKER. Yes. I think, Mr. Chairman, that it is fair to say that to take a broad shotgun approach to the reporting all international transactions would not be workable. Of course, there are hundreds of thousands of, perhaps even millions of legitimate proper business transactions that are international in nature that are conducted every day. We simply could not impose a burden on those engaged in these transactions to report them to us. However, where we are dealing with institutions which we have reason to believe are engaged in illegal activities or are facilitating illegal activities, it seems to me a reasonable approach would be to require the reporting of transactions with those institutions.

Even that may leave us with too large a universe because there may very well be a majority of their transactions may very well be legitimate. But perhaps we can define the universe data a little further by targeting the transacting agency as well, for selective reporting. So what we think we can do here is to define criteria which would apply to achieve the degree of selectivity that we think is appropriate and at the same time recognize that we have to balance the legitimate interests of commercial enterprises.

Chairman ROTH. One of my concerns is that in looking at these problems, it is also easy for us to suggest to Congress to enact further requirements, the result of which is really not more enforcement but just more redtape. I think that is one of the reasons we are in some of the difficulties we are in.

Mr. WALKER. Mr. Chairman, the proposal that we made here can be accomplished without additional legislation. It would be greater utilization of our existing authority, which we have chosen not to exercise for reasons that I think are apparent. But we are now seeing such a volume of illegal transactions or transactions of an international nature related to illegal activity that we think we have to take a hard look at the possibility of imposing additional reporting requirements. But we have existing authority to do that.

Chairman ROTH. Given the large number of CTR's and CMIR's filed each year, both domestically and on behalf of foreign entities, is the Federal Law Enforcement Center capable of handling them? If not, what recommendations would you make?

Mr. WALKER. We established, early last year, the Financial Law Enforcement Center in the Treasury Department, which was an expansion and a beefing up in effect, of the Transactions Reporting Unit, which has been located within Customs. And we assigned additional personnel to that center. We maintain the ability there to classify, correlate and computerize the data that is reported in the CTR's, CMIR's and then to analyse this data. From these records which are useful in either pursuing leads that we already know about or in developing a data base which can lead to the initiation of financial investigations. So we use it, in effect, both ways. We have used the Financial Law Enforcement Center quite extensively in supporting our Operation Greenback.

I think that as the volume increases, we will have to consider increasing staff. Right now, I see that from the CTR's, CMIR's that have been filed, we had a rapid increase in the numbers of reports from the year 1977 up to 1980 and into 1981 with the CTR's reaching 350,000 but in the first three quarters of 1982 the numbers were 282,000. So we were running about the same in 1982 as we were in 1981. The CMIR's indicate a steady growth and I do not know whether we will see a leveling off there. So we are looking at it very closely. We will have to assess our resource needs as we go forward.

Chairman ROTH. In terms of ironclad secrecy, how would you rate the various havens? What are the most difficult ones to penetrate?

Mr. **Walker.** I think that we would select a target or make note of Panama, the Caymans, Netherland Antilles, I think to some extent the Bahamas. These are all havens which we believe are utilized with quite some regularity by those who wish to make use of the tax havens for illegal purposes.

Chairman **Roth.** Do you think the Caribbean Initiative, which uses a carrot approach, would help solve this problem, substantially solve this problem or just have minimal effect?

Mr. **Walker.** I do not think that it is going to solve the problem because I think that the bank secrecy requirements or bank secrecy laws, which operate in these countries are still remaining and will remain the principal obstacle to our being able to get the kind of information that we need.

Chairman **Roth.** So you do not feel that the provisions covering this aspect really are that meaningful?

Mr. **Walker.** I would like to, if I could, defer to Mr. Granwell on this.

Mr. **Granwell.** Mr. Chairman, in the context of the exchange of information which is required under the CBI proposed legislation the provisions are drafted broadly to include both civil and criminal matters and to insure piercing of financial disclosure laws. I think it will be up to a particular jurisdiction to decide whether the benefits derived by extending convention treatment to that particular jurisdiction outweight benefits from its acting as a financial intermediary or tax haven. Under our agreements, as we propose that they be implemented, the financial secrecy laws would be pierced as a condition precedent to having these benefits extended.

There is thus, a weighing of which benefit the jurisdiction will choose.

Chairman **Roth.** What kind of cooperation are you getting from other agencies of the Government such as the Justice Department and State Department? In many of these areas we find there is an appalling lack of cooperation. How would you characterize the cooperation in this area?

Mr. **Walker.** Mr. Chairman, I think it is fair to say that, historically, cooperation in law enforcement, particularly in drug enforcement has been difficult. But it is a problem that I think all of us in the current administration recognized very early on and addressed. We have attempted to do as much as possible to promote a proper cooperation and coordination between the agencies responsible for drug enforcement. I think it is fair to say that the real cooperation between Treasury agencies and Justice agencies today is better than it has been. Indeed, I would go so far as to say it is better than it ever has been. That does not mean that we do not have problems that have to be worked out on a frequent basis. We are managing large agencies that operate and interact with other agencies at many different levels. No one can insure perfect cooperation at every level all the time. This constantly has to be monitored and watched. But I think that the spirit of cooperation is very high right now and generally we are seeing a very good level of cooperation.

One example, of course, that comes to mind is the Vice President's task force in south Florida. In that task force, agents were drawn from Treasury. We had the Bureau of Alcohol, Tobacco, Firearms, Customs, and IRS in there. DEA, FBI and numerous other Justice agencies, Bureau of Prisons, INS and others were brought in. The Coast Guard was involved. The military was involved, various agencies of the Department of Defense, services were involved and also State. All of these various agencies of government were together and were, I think, effectively coordinated and with their resources and operations effectively brought to bear on the particular problem that we had there.

So I think that serves as a model for cooperation. It does not serve as a complete answer to the need for cooperation nationally. We still have a ways to go.

Chairman ROTH. You are, to be candid, much more positive than I am. I am somewhat familiar with the Vice President's task force, which I think agrees with you. It did work reasonably well. But as I understand it, that particular arrangement is coming to an end, but even when it was in effect, for example, whoever was involved, as I understand it, had limited authority. They had no direct authority obviously, over a Navy ship to take certain actions. So that, I will be frank, I still have grave concerns as to effectiveness of our cooperation. I think it has moved up but I think it has a long ways to go yet.

As I said the other day, I am sometimes concerned that we are disorganized Government trying to attack or penetrate organized crime. It seems to me it is a very critical problem that really has not been sufficiently answered. I do think you are right, that some progress has been made.

I would like to go back to CTR's. Some of the information we received from Treasury, with respect to currency transactions involving entities using non-U.S. addresses raises several questions.

In 1981, these non-U.S. currency transactions totaled $8 billion. It is a rather large amount of currency. For instance, currency transactions from the Bahamas totaled $151.8 million, from the Cayman Islands, $113.8 million, from Colombia, $327.5 million, from Panama, $155.3 million, from Switzerland, $761.6 million. Can you shed any light on why we are seeing these extremely large currency transactions in these countries?

Mr. WALKER. I would like to ask my deputy to respond to this question, Mr. Chairman.

Mr. POWIS. Mr. Chairman, we believe what we are seeing here is more and more currency leaving the United States and going to the places that you mentioned in particular and then filtering back through. We believe that that, to a considerable extent is a product of narcotics trafficking activity.

Chairman ROTH. Product of what?

Mr. POWIS. Narcotics trafficking activity, narcotics profits.

Mr. WEILAND. Mr. Chairman, I would point out that the staff has scheduled a good deal of the currency attributed to Panamanian sources and virtually all of that is provable to the extent of having to do with narcotics related cases.

Mr. POWIS. I think the latest indications we have is that it is going up.

Mr. WALKER. We seem to have reached, in the past year, quite a change from the previous year of currency coming in to banks, into the United States from Panama. This is currency that would be taken out, then would come back in to the Federal Reserve System.

Chairman Roth. Eleanore?

Ms. Hill. No, thank you.

Chairman Roth. Gentlemen, thank you very much for being with us today.

Mr. Weiland. Mr. Chairman, we have some staff material that we would like to present, perhaps tomorrow, we could not get to today. For the record at this point, I would like to submit several articles including an editorial from the newspaper in the Caymans and two articles from the Nassau Guardian, all of which relate to the issue we discussed today.

[The interest of several Caribbean countries in the preservation of bank secrecy and in President Reagan's Caribbean Basin Initiative are reflected in numerous articles which the subcommittee staff has collected. An editorial from the Caymanian Compass, and two articles from the Nassau Guardian in the Bahamas follow:]

[From the Caymanian Compass, Mar. 31, 1982]

Mr. Reagan's Initiative

As published on the front page of yesterday's edition, the United States Senate is looking into the proposal of President Ronald Reagan to pump hundreds of millions of dollars in aid into the Caribbean Basin . . . a laudable gesture at the outset.

Also contained in that article, however, which was reprinted from the Los Angeles Times, was the rider that perhaps in exchange for this American largesse could be the requirement that tax havens in this region—like the Bahamas, Panama and the Cayman Islands, might have to offer fuller co-operation when the Internal Revenue Service comes calling with requests for information on bank accounts, etc. of Americans.

Now, it seems the Cayman Islands has gone this road before. The Confidential Relationships (Preservations) Law clearly spel's out such divulgence of information to be an unlawful and punishable act. The U.S. authorities are undoubtedly aware of the details of that law and the constant hints from the U.S. mainland that such laws are designed to attract American tax lawbreakers holds no water, since it tacitly suggests that a law enacted by another territory, were it not explicitly mindful of U.S. legal requirements, should almost automatically be regarded as anathema to hemispheric harmony.

As U.S. President Reagan heads for his Caribbean Basin talks, he should be reminded that, in the first place, the Cayman Islands is a colony of Great Britain, and thus do not have even the diplomatic authority to argue the point. It is rather Britain's prerogative—and perhaps now her duty—to petition the American chief to suspend that country's wrath over our secrecy laws in appreciation that they were enacted for the economic benefit of the Cayman Islands, and always with a view that so far as territorial sovereignty is concerned Cayman has never been, is not, and never intends to be a transgressor of international law.

We cannot speak for the Cayman Islands Government. We certainly cannot speak for the British Government; but from the standpoint of reasonable observers of the current scene, we feel Mr. Reagan is critically damaging the selfless spirit of his Caribbean Basin Initiative if his policy will be to guarantee aid and trade incentives only to those regional territories which agree to compromise their own national initiatives.

At this point the question of Cayman's need for U.S. assistance--whether in the form of favourable trade agreements, industrial or educational support—does not arise. What is at stake is a territorial principle, but one which centres on the lifeblood of this colony. The U.S. report was careful to note the number of banks registered here and pit that against the number of residents, however inflated in the latter instance, but there was excluded the comfortable standard of life all this has afforded the people of the Cayman Islands, and if the touted philosophy of Mr. Reagan's Caribbean Basin Initiative is to raise the standard of life in the Basin, then somebody in Washington is not correctly assessing life in the Cayman Islands as it has existed in recent times.

Whilst the Caribbean and the Cayman Islands welcome Mr. Reagan's interest in the economic welfare of this region, it is a source of wonderment that America after all her diplomatic foibles in the area, would seek to strike an unconscionable bargain even as she reaches a hand across the table.

The Internal Revenue Service has its problems with policing taxpayers, but it has become a sad day indeed when America seeks to compromise the laws and regulations of other, tiny countries in order to tidy its domestic calamities.

[From the Nassau Guardian, Mar. 24, 1982]

BAHAMAS SHUT OUT FROM CARIB BASIN PROJECT

(By Vern Darville)

The Bahamas has been all but totally excluded from assistance from the United States as part of President Reagan's Caribbean Basin Initiative (CBI), the plan designed to rescue the faltering economies of the Caribbean from communism.

This archipelagic nation has been denied an exemption (already granted to other neighbouring nations such as Mexico and Canada) from anti-offshore-convention tax legislation, a factor considered crucial to the continued growth of tourism, the Bahamas' mono-crop industry which generates most of its foreign exchange requirements.

And this country is not included among those nations of the region which meet all the stipulated requirements of a beneficiary developing country, a status which was granted this week to all member-countries of the Caribbean Common Market—Antigue, Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis, St. Lucia, St. Vincent and The Grenadines, and Trinidad and Tobago.

Further, the prerequisites being placed on Bahamian participation in the plan all but rule out any local application for the plan since the U.S. demands that tax havens such as The Bahamas and Cayman Islands co-operate with U.S. investigations of American citizens' secret bank accounts here would require a major policy shift by the current government.

There is a possibility that rum produced in The Bahamas might qualify for duty-free entry into the U.S. as part of the plan, as would other Caribbean rums, but it would seem as if even this is contingent on Bahamian agreement to open up its banking files to Internal Revenue Service (IRS) agents.

Already the CBI has been the subject of derision by members of the Progressive Liberal Party in Parliament. Among those parliamentarians denigrating the much touted plans were Senate Leader Kendal-Nottage who indicated that his government had given up hope of any assistance from the plan. The consensus among local politicians is that this country will benefit the least, if at all, from the plan.

Ironically, Nassau was the venue for the original meeting of the Foreign Ministers of Canada, the U.S., Mexico and Venezuela, who decided to pursue a regional assistance effort in an attempt at preventing their own nations from being sucked down the economic whirlpool apparently affecting Caribbean Basin countries.

It was that event which led Bahamians to believe that perhaps the U.S. had something special in mind in the way of assistance or aid for this country, a feeling which quickly evaporated as details of the U.S. philosophy governing its part of the initiative were unveiled.

President Reagan unveiled his "self-help" programme for the region in a speech on February 24 which called for a 12-year free-trade zone for Caribbean products, $664 million in emergency, short-term aid ($100 million for El Salvador and substantial amounts for countries such as Costa Rica, which is on the verge of Bankruptcy, and Jamaica), tax changes to encourage investment, treaties to set up a framework for investments, an expansion of protection by the U.S. Export-Import Bank and a rebate of excise taxes on all imported rum to Puerto Rico and the Virgin Islands "to help protect this vital export in competition with Caribbean nations."

Although it was indicated early in the planning stages by the U.S., The CBI was officially turned into an assault against tax havens by the Reagan Administration after his February announcement when it was disclosed that tax havens such as The Bahamas would be required to co-operate fully with U.S. tax agents in investigations involving American citizens with secret accounts here if they wanted to participate in the initiative.

And there is a suggestion being voiced by at least one U.S. Senator that the U.S. take punitive action against nations that refuse to help income tax investigators. The official U.S. concern is for the secret Caribbean bank accounts of drug traffickers and underworld figures and it is seeking the co-operation of tax haven countries "in order to preserve the integrity of the U.S. tax system."

In a letter to the Speaker of the (U.S.) House (of Representatives) and the President of the Senate regarding the CBI this week, President Reagan wrote: "In accordance with Section 502(a) of the Trade Act of 1974, as amended, I herewith notify the House of Representatives/Senate proclaiming that all member countries of the Caribbean Common Market shall be treated, respectively, as one country under Section 502(a)(3) for the purpose of the generalized system of preferences. I have determined that Caricom and its member countries meet all the requirements of a beneficiary developing country. . .

"My decision was made after giving due consideration to the following factors. . .:

"(1) The request of Caricom that it be designated as an association of countries which is contributing to comprehensive regional economic integration among its members . . . including inter alia, the reduction of duties;

"(2) The level of economic development of the member countries of the Association, including their per capita Gross National Product, the general living standards of their populations, the levels of health, nutrition, education and housing of their populations, and the degree of industrialization of the countries;

"(3) The fact that I will urge other major developed countries to treat this Association as one country under their generalized tariff preference schemes, and,

"(4) The fact that this association provides the U.S. with equitable and reasenable access to its market.

"In making the decision to designate this association, I have also considered congressional interest in encouraging regional economic integration among the developing countries as a means of fostering the political and economic viability of these countries and fulfilling their development goals. . ."

The U.S. decision to exclude The Bahamas from direct aid or assistance in the CBI follows a recent decision by the World Bank to "graduate" other countries, such as The Bahamas, from development aid because of the fact that their percapita gross national products exceed the bank's "benchmark" GNP figure.

Some of the countries, he said, have traditionally "refused official U.S. inquiries into the channels through which illicit cash flows."

At the conference of international banks held in New Providence last week, one financial expert spoke on the systematic attack against tax havens currently underway in the United Kingdom, Europe, the United States and within the United Nations framework, which, if effective, will mean the probable elimination of tax havens.

The Reagan Administration, according to the Herald, is seeking cooperation from Caribbean bank-secrecy nations "in order to preserve the integrity of the U.S. tax system."

Stephen Shay, a tax analyst with the Treasury Department, noted that information is being sought which the Internal Revenue Service would request in the course of a civil audit or a criminal tax investigation and he indicated that the problem with foreign bank abuse may be getting worse, as an increasing number of individuals and small businesses are taking advantage of the situation. Countries in this category include The Bahamas.

Treasury Department officials said an overlooked section of the plan provides for "exchange of information agreements" between the United States and all countries seeking to benefit from trade and investment incentives under the plan.

Officials in the Bahamas and Caymans, to date, have cooperated with U.S. authorities in ordinary criminal investigations, it was noted, but have refused to provide bank records of American citizens in income tax investigations.

[From the Nassau Guardian, Mar. 23, 1982]

Britain, U.S. Cracking Down on Tax Havens

(By Vern Darville)

Proposed British anti-tax haven legislation slated to be passed into law by August with retroactive effect to April will have "very serious financial implications" and might wreak "inconceivable economic damage . . . to the overseas business of British industrial companies and British banks," according to a United Kingdom-based financial expert.

Alun G. Davies, reporting to a conference of international banks here last week on the systematic attack against tax havens currently underway in the United Kingdom, Europe, the United States and within the United Nations framework, spelled out possibilities which foreshadowed the probable near-elimination of tax havens.

In addition to the British legislation, the United States is considering proposals designed to crack down or eliminate tax havens even to the extent of extending its taxation to include shipping in tax havens, Mr. Davies disclosed.

The proposed U.K. legislation, among other measures, seeks to amend the law on company residence.

"What they had in mind was that companies had been set up in tax havens and provided the directors held their meetings in the tax haven, there was little the Revenue could do or did about it," he said. "The company was insulated from the U.K. tax system until it remitted dividends there. The Revenue proposed that companies should be taxed in the country where the practical day-to-day management took place (since it) suspected that, with the growth of innovation in communications, the telex and the telephone could be used to run a tax haven company from London without any real presence in the tax haven."

Consultative documents issued in 1981 noted that the British Government was "very anxious to counter avoidance of U.K. tax by the accumulation of profits and investment income of U.K. groups of companies inside tax haven subsidiaries," and that the main trading partners of the U.K. had introduced legislation about tax avoidance by way of income accumulation in tax haven subsidiaries, such as the U.S., Germany, Japan, Canada and France.

Mr. Davies said that, broadly, the Inland Revenue proposed to tax the share of a British company in the income and capital gains of tax haven companies.

"The attack was directed against companies with a 'privileged tax system' which did not make adequate dividend distributions," he related, noting that "privilege" was defined as either no tax at all or at a significantly lower level than that in the U.K.

The banker indicated that, despite the flood of criticism, most of it implacably hostile to the Inland Revenue propositions, another set of consultative documents including draft clauses of the proposed legislation were issued late last year and that "it was decided to proceed with them."

"In fact," he told the bankers conference last week, "the draft clauses show little impact on the Revenue's mind of anything said in the many public comments on their original proposals. The timetable left between Christmas and the Budget speech shows no real feeling for consultation or amendment. The question is whether the proposals will be pushed through irrespective of public criticism or Parliamentary comment."

Mr. Davies argued that, if the revenue proposals on tax havens, which are intended to be law by August and to be in effect from April 6, are passed into law, "trading by British groups through tax havens will never be the same again."

According to him, the tests laid down are "so tight and restrictive that they are so difficult to pass as the scriptural test of the camel passing through the eye of a needle, and it is possible that inconceivable damage might be done to the overseas business of British industrial companies and British banks."

He pointed out that the British tax collectors have vigorous ambitions to sweep up what they deem to be the iniquitous use of tax havens "but they have not costed the administrative overhead necessary for enforcement nor the increased tax yield they may expect into their coffers."

The proposed legislation, he reported, is designed "to catch all British companies with an interest of 10 per cent or more in a tax haven or in a country with a 'privileged tax regime' (defined as less than 50 per cent of the nationally compared U.K. tax of the overseas company)."

Capital gains in the tax haven will not be caught, but the income will be liable at corporation tax rates in the U.K., less any credit for tax paid outside the U.K., explained.

And he told of three tests by which tax havens can escape the proposed U.K. tax dragnet:

The genuine trading test (not available for holding companies)—This test is so tight as to eliminate most tax haven companies. There must be a permanent business establishment, adequately staffed, with the general direction and the day-to-day management in the hand of locals who act independently of nonresidents, with no services for the company provided from the U.K.

Mr. Davies noted that, by definition, private investment business (the holding of security or patents or dealing in securities or leasing or investment funds) cannot qualify as genuine trading activities, while "financial business" (which includes banking, insurance and shipping) cannot qualify unless less than 50 percent of the business comes from sources other than related companies.

In relation to banking, "there is the further obstacle that it cannot qualify as 'genuine trading' if the 'capital interests' of those in control of the company from the U.K. comes to more than 15 percent of the 'outstanding capital'," he told the conference.

"It seems to me," he commented, "that the Revenue don't like offshore banking and proposes to sweep it up into the U.K. tax net."

The acceptable distribution text—50 percent for traders and 90 percent for holding companies.

The motive test—to show that the company's income arose from bona fide commercial transactions, and that avoidance of U.K. tax was not one of the main purposes of those transactions.

Mr. Davies emphasized that there is "considerable unease in the U.K. business community interested in overseas trading that, if the proposed legislation comes off, it will have very serious financial repercussions—it will in fact be far more restrictive than the general Revenue oversight and the Bank of England exchange control which was in existence prior to 1979."

The U.K. banker then turned his attention to proposals currently before the U.S. Treasury by Richard Gordon, special counsel on international taxation, which include requiring that the books and records of foreign subsidiaries be maintained in the U.S., unless they are made readily available to Internal Revenue Service (IRS) agents on demand, and bringing about greater certainty in regulations governing transfer pricing.

Further, the U.S. proposals would define tax havens in the same way as Japan, France and Australia have done and would require more physical activity and local management of control in order to exempt more clearly from U.S. tax the income of tax haven entities.

Another proposal would strike at the present rule whereby tax haven income, being foreign source income, is creditable for the foreign tax credit.

Mr. Davies explained that existing regulations, while they switch tax haven base company income into the U.S. net, does not present the same income being available for excess double tax credit. The proposals being considered "would strike at this, with costly results for U.S. companies."

And a new basis is being suggested for foreign corporations controlled from the U.S. in which U.S. tax jurisdiction would be extended to cover all foreign corporations controlled in the U.S. by the imposition of a test like the British management test.

At present the mere fact that a corporation is not a U.S. corporation gives it automatic deferral.

The U.S. proposals suggest a change in the 50-percent control test by dropping it to 25 percent and an extension of its jurisdiction to include premiums from foreign controlled corporations such as captive insurance companies which are highly aggressive in tax havens.

Mr. Gordon's proposals seek to extend the taxation of shipping in tax havens by a direct extension of U.S. taxation to offshore shipping.

Additionally, Mr. Davies related, the U.S. is considering the possibility of pulling out of tax treaties with former colonies negotiated by their former colonisers, using the example of the U.K. decision to change its tax treaty with Barbados when it became a partial tax haven.

Among recommendations being considered the following measures which could conceivably be taken against recalcitrant tax havens which refuse to cooperate with U.S. authorities:

The U.S. would increase its withholding rates to that jurisdiction from 30 to 50 percent.

Loans from that jurisdiction should be treated as income unless the contrary is fully proved.

All income from that jurisdiction should be designated U.S. source income, so as to prevent effectively excess credits from being used.

U.S. airlines would be prohibited from flying to the tax haven and vice versa.

U.S. banks would be prohibited from conducting business in the designated tax haven or, alternatively, all wire transfers to and from the U.S. would be forbidden.

Mr. Davies' opinion was that, while it is certain that some of the suggestions will be adopted, thus whittling down the advantages of tax havens to U.S. citizens or to third party countries investing in the U.S., the administration of tax haven elements of tax audits in the U.S. is "so patchy and the area of operations so vast, it is difficult to assess which of the particular recommendations may be adopted."

[The Chicago Sun-Times reported on February 25, 1983, the sentencing of Chicago attorney Robert L. Tucker in a $5.1 million swindle. The case is of interest to the subcommittee in that $3.6 million was sent to Hong Kong and has not been recovered.]

LAWYER TUCKER GETS PRISON TERM

(By Maurice Possley)

A federal judge, with a tear in his eye and a trembling hand, sentenced prominent Chicago attorney **Robert L. Tucker to 15 months** in prison for his role in a $5.1 million swindle.

U.S. District Judge Charles P. Kocoras briefly struggled with his emotions as he sentenced Tucker and two codefendants.

"It is a tragedy of monumental proportion. There's no question about that," Kocoras said. "I am not unmindful of the esteem in which you are held by my fellow judges. . . . I do not think that you are an evil man."

Tucker, 54, a civil rights official in the Nixon administration and a onetime Chicago mayoral candidate, was convicted Jan. 12 along with his client, Deborah Bell, and Michael W. Ball, a Florida freight forwarder. The three were convicted of conspiring to defraud Continental Bank and Guatemala in a proposed deal to ship 6,600 metric tons of black turtle beans to the Central American nation.

Bell, 62, executive director of a Northwest Side commodities firm, RuMex International, was sentenced to two years in prison. Ball, 35, was given nine months in prison.

Kocoras also ordered Tucker and Bell to make restitution of $5 million should any money be recovered. A total of $3.6 million of the $5 million was sent to Hong Kong during the 1980 deal, but was never recovered.

Assistant U.S. Attorneys Mary Stowell and Michael Siegal charged that phony documents were submitted to Continental to obtain a $5.1 million letter of credit for RuMex. The documents falsely said the beans had been purchased and were en route to Guatemala. The beans were never delivered.

Tucker told Kocoras, "I did not do this. I have never been involved in this transaction. My role was at all times and continues to be that of a lawyer. [I] never was involved in the black bean transaction."

Siegel said, "This is a tragedy. Mr. Tucker is an outstanding attorney. He is an extremely intelligent person and a very likable man. But what I find particularly aggravating is that following his conviction he made public statements that there was some sort of conspiracy by the government to get him."

Kocoras said that on Wednesday night he had restudied his judicial oath. "That oath says in part, 'I will do equal justice to the poor and the rich.' "

He added, "I don't know how many of the Guatemalan hungry stayed hungry . . . I don't know how many of the Guatemalan poor had to pay twice the price for their daily sustenance."

[Panama has a high degree of bank secrecy. By late 1982, there were 126 banks in Panama with deposits of over $30 billion. An article in the Wall Street Journal, dated August 6, 1982 follows:]

PANAMA IS SAFE HAVEN FOR 116 FOREIGN BANKS FREE FROM REGULATION

(By Lynda Schuster)

PANAMA CITY, PANAMA.—About 10 years ago, some farsighted politicians decided to turn this muggy capital into an international banking center. Only about 20 banks were in business here at the time, but because of Panama's propinquity to two continents and because it had good communications facilities, the country looked like a potential bankers' mecca. To woo banks, Panama changed its laws to encourage banking secrecy and waited for the money to pour in.

The timing was perfect. Panama opened for international banking business just in time to catch the outpouring of OPEC-oil-related dollars. Today, there are some 116 foreign banks here with about 11 times the deposits of nine local banks.

The foreign banks are one reason that Panama, unlike other Central American countries, is relatively prosperous and tranquil. Panama still has the palm trees, poverty and potent politics common to Latin America. But it also has luxury condominiums, booming businesses and glittering glass-and-steel skyscrapers that make the place look more like Miami than part of an underdeveloped region susceptible to revolutionary convulsions.

THE CASH FLOW

"This country owes its place in the sun to the international financial community," says John Cogswell, a native of Baltimore and a businessman who has lived in Panama for 35 years. "And it owes much of its stability to the fact that there's still money around here."

Other Central American countries are being sucked dry because nervous bankers have cut off vital lines of foreign credit. But Panama is positively liquid. The profitable canal and nearby free-trade zone account for part of it. But the banks, too, helped to finance local businesses, a construction boom and much of the countrys borrowings. Furthermore, the mere presence of the banks keeps Panama looking like a good risk at a time when investors are pulling out of Central America.

That Panama has been able to hold its own in the midst of regional turmoil affecting El Salvador, Guatemala and Nicaragua is particularly important to the U.S. Despite an unexpected change in presidents last week, the relative stability of Panama means fewer fears for the future of the Panama Canal; complete control of the canal will pass to Panama in the year 2000, and it remains a trade and strategic lifeline for the U.S. Also, there are fewer fears about the $3.2 billion U.S. investment in Panama.

Panama "is a bright spot in an otherwise dismal part of the world," says a Western diplomat here. "And that's lucky for us because the canal is just about the only way we can move oil, coal and warships."

IN IT BUT NOT OF IT

The banks' contributions to Panama's prosperity raise a few eyebrows, however. Critics charge that all the foreign money hereabouts gives an appearance of national health when in fact not enough of these funds find their way into the local economy. Agriculture and industry have been pretty much subordinated to the glamor of the "international" economy here, critics say. And stagnation in those sectors is slowing Panama's growth. Moreover, a lot of Panama's deposits are the proceeds of neighboring Colombia's burgeoning illicit drug trade—tainted money that the banks wouldn't be able to touch if they were properly regulated, critics assert.

Nonetheless, most observers agree that Panama would more closely resemble its ailing Central American neighbors if it weren't for the banks. Historically, Panama has recognized only physical attachment to Central America. It has forged its economic and political links with South America. The Spanish conquerors used it as a transit zone for the silver-mined in Peru and shipped to Spain. Panama was a province of Columbia until it won independence in the early 1900s. There wasn't even a road to Costa Rica to the north until 1948.

MONEY IN THE BANKS

Unlike Central American nations that developed agrarian economics run by oligarchs, Panama concentrated mostly on handling the flow of goods and traffic that passed through its territory. Its service economy helped spare Panama the political violence over the ownership of land that troubles others in Central America. To be sure, Panama's distribution of land isn't egalitarian either. But it just isn't that big an issue because about half of Panama's 1.8 million people live in or near Panama City and about 60% of the gross domestic product derives from services.

The idea of luring banks to Panama started in 1969 when Nicholas Ardito Barletta, as minister of planning and economic policy, was trying to find a way to broaden the economy. Mr. Barletta, who now is with the World Bank in Washington, says he wanted somehow to ensure a sustained supply of money and credit that would be independent of the canal the U.S. was still running, and of the free-trade zone in nearby Colon, which is the second-largest duty-free area in the world after Hong Kong.

The solution he hit upon was to turn Panama into an offshore, or Eurocurrency, banking center. Eurocurrency refers to any country's currency on deposit outside the country, and the market exploded in the 1970s with the rush of oil money.

Mr. Barletta says he figured that there were lots of reasons for banks to come to Panama. Foreign companies abounded because of the canal; there were lawyers in profusion. And bankers wouldnt have any foreign-currency translation losses because Panama works in dollars. (Although the official currency is the balboa, it is illegal under the constitution to print it. So Panama uses the dollar, calls it the balboa, and has coins minted in the U.S. that are the same size and shape as U.S. coins.)

But Panama was new at banking. It had very few applicable laws and no central bank to regulate things. And Mr. Barletta says he was wary of "paper" banks, mere mail drops of the kind that brought unsavory reputations to some of the Caribbean islands that also are international banking centers. So Panama put together a banking commission to scrutinize applicant banks, passed laws requiring banks to maintain offices in the country and created a banking code that made offshore transactions tax-free and very discreet: "more secret than Switzerland," Mr. Barletta boasts.

Today, banks with names like First National Bank of Boston and Bank of Tokyo seem as numerous as the palm trees lining the downtown Via Espana. About 65 banks have general licenses allowing them to do local and offshore transactions; about 45 are allowed to do only offshore business; some 15 banks don't make transactions but have representative offices in Panama. Altogether, banks in Panama have about $38 billion in deposits.

Despite the world-wide recession, banking still manages to employ about 8,000 workers, which is about the same number doing work associated with the canal. Besides all the direct employment they provided, the banks created a need for a bunch of related businesses ranging from custodial to construction. But perhaps the biggest plus is that those 65 banks licensed to do so are pretty willing to lend to local businessmen.

Carlos Hoffman has a stel-pipe manufacturing concern on the Transisthmian Highway that runs between the Pacific and Atlantic coasts. He sold about $1.7 million of pipes last year and has a $35,000 line of credit from Bank of Miami at about 17% interest. He says he is lucky, for if he were anywhere else in Central America, he would probably pay about 50% interest, that is, if he could get a loan at all. "Just about anyone can walk in off the street and float a loan here," he says, because of the many competing banks.

Nonetheless, Mr. Hoffman and a host of others don't think that concessions on interest rates are enough. Ricardo Arias Calderon, the head of the opposition Christian Democratic Party, says it's "just not right" that relatively little of the money coming into Panama falls into local hands. The problem, he says, is the creation of two parallel economies: an international one that has experienced robust growth and a local one that has gone virtually unattended.

As a result, unemployment is running at about 17% in the nation. It's even worse in the city of Colon, where about a third of the work force is unemployed and tensions run high in the rotting tenements with windows displaying laundry trying to dry in the perpetually moist air.

Economists predict the Panamanian economy will grow by less than 3% this year, in contrast to 6% just three years ago. One of the main reasons is a slump in construction, a business that may never rebound because tiny Panama has no room left for new building. The suggestion that Panama's prosperity may not continue makes a lot of people nervous about the future of what has been a mostly graceful adjustment to the new political alignment in the national guard follow-

ing the death last year of its leader Gen. Omar Torrijos, who died in a plane crash.

Charges of corruption and a deteriorating economy last week forced President Aristides Royo out of power; he was replaced by Vice President Ricardo de la Espriella. And now some here worry that an increasingly impoverished and restless population will make the powerful national guard reluctant to return the country to civilian rule with elections promised for 1984.

Warns Guillermo Chapman, a private business consultant: "We've got to turn our attention to finally developing light industry and agriculture. Otherwise, we're going to be looking at 25% unemployment and more vulnerability to turmoil.

For that reason, Panama now is trying to pass a law that would oblige the banks to lend $20 million to farmers every two years. After all, agriculture declined 1.2% last year, while banking grew 22%, some critics say. "We scratch their backs, so we think they ought to scratch ours," says a government official. "We have liberal laws and don't bother the banks. They can accept whatever money they want on deposit, even if it's illicit from drug trafficking. It's time they return the favor."

Predictably, bankers aren't too pleased with the idea of making loans to foster Panamanian social purposes. "We're here because the Panamian government has been committed to not rocking the boat," says Michelle Colburn, an international loan officer at Marine Midland Bank. Adds a European banker: "I'm not here to act as a charity. I'm here to make money, and that is exactly why Panama wanted us in the first place."

[In January 1983, the Supreme Court of Jamaica, which serves as the appellate court for the Cayman Islands, made an historic ruling. The decision affected a federal fraud case known as Interconex. A Wall Street Journal article dated January 11, 1983 follows:]

CAYMAN ISLES' SECRECY LID PRIED LOOSE BY PRECEDENT-SETTING U.S. FRAUD CASE

By Robert E. Taylor

WASHINGTON.—About six years ago, when Joseph C. LeMire was looking for a discreet place to stash hundreds of thousands of dollars, he selected the Cayman Islands, a sprinkling of sand on the sea between Cuba and Jamaica with one of the world's tightest business-secrecy laws.

Mr. LeMire had reason to believe that the local laws would block anyone from tracing the money to him.

He was wrong.

Today, Mr. LeMire and three associates stand convicted of a $2 million fraud against his former employer, Raytheon Co. Some of the crucial links in the chain of evidence against Mr. LeMire were supplied by Cayman banks and registered-company agents.

FOUND AN OPENING

Justice Department officials long have regarded the Caymans as a site of extensive illicit money laundering, shielded from outsiders by near-impenetrable secrecy. The LeMire case, they say, gives them an opening they can exploit again.

In the case, U.S. efforts failed at first to get local authorities and courts to open bank records. But the Supreme Court of neighboring Jamaica doubles as the Caymans' appeals court, and there prosecutors obtained the order that pried open the books of Cayman banks and company agents.

In the process, the U.S. established a precedent that Cayman banks must cooperate with certain kinds of requests from U.S. courts.

"The belief that you have a safe haven in the Caymans if you commit a fraud, that has been shattered," says Robert Ogren, head of the Justice Department's fraud section. He says the LeMire case "makes it clear that we can get evidence (from Cayman banks) if we're willing to commit the resources."

MORE EFFORTS SEEN

Deputy Assistant Attorney General Roger Olsen says, "We're perfectly prepared to litigate it all the way up in every case," if necessary. He predicts the U.S. "will be getting more from them (Cayman banks) on a regular basis," using the same approach, which has never been tried before in the Caymans.

Cayman bankers occasionally cooperate with U.S. prosecutors or civil courts. But experts say this happens rarely, generally in cases where disclosure is in the bank's own interest. One bank disclosed, for instance, that an officer's signature had been forged. Another agreed to freeze money in an account in response to a U.S. judge's order but refused to divulge information about it.

Cass Wieland, chief counsel to the Senate Permanent Investigations Subcommittee, says Cayman officials frequently promise cooperation with proper requests from foreign prosecutors but seldom deliver. "They would like the rest of the world to believe it (their secrecy law) is airtight," he says.

FIRST COURT ORDER

Prosecutors say the LeMire case was the first time anyone obtained a Cayman court order forcing banks and agents to divulge information to a foreign court against their will.

Mr. LeMire was accused of padding a shipping contract by about $2 million and splitting the overcharge with his co-conspirators. (Most of the defendants are expected to appeal.) It took prosecutors three years to trace the money through Swiss accounts of Liechtenstein companies to banks in Bermuda and the Caymans. Then, to show that Mr. LeMire wound up with part of the cash, the U.S. needed to link him to the almost $1 million that went into Cayman accounts.

When Justice Department lawyers first sought Cayman records, banks refused. The islands' attorney general said he was helpless to force disclosure. After the U.S. filed a request for international judicial assistance, the Caymans' Grand Court denied a request that it force disclosure.

Cayman attorneys for the U.S. appealed the request to the Caymans' appeals court in Kingston, Jamaica.

Citing British imperial statute—the Caymans are part of the British West Indies—the appeals court ruled that disclosure is mandatory if the request is for specific documents relevant to a prosecution in which charges have been filed, and if the offense would be a crime in the Caymans. It said all these elements were clearly present in Mr. LeMire's case.

PURPOSE OF LAW

Going further, it emphasized that the Cayman's business confidentiality law wasn't intended to shield criminals. "There is nothing in the statute," the court said, "to suggest that it is the public policy of the Cayman Islands to permit a person to launder the proceeds of crime in the Cayman Islands, secure from detection and punishment."

Complying with that ruling, the Cayman Grand Court ordered two banks to disclose records and ordered bank officers and company agents to answer questions on videotape for U.S. prosecutors. One agent testified in person at the trial in Washington.

U.S. prosecutors concede that the LeMire case isn't a panacea for Cayman confidentiality. Such procedures are costly, time-consuming and available only after indictment. And they expect other obstacles to arise. Requests still can be challenged as "fishing expeditions" or as irrelevant to the criminal case, for instance. But appeal to the Kingston court is available, and, according to the Justice Department's Mr. Olsen, will be used.

Department attorneys view the LeMire precedent as a valuable addition to their growing arsenal of weapons to pierce foreign bank secrecy. Another weapon is the subpoena for foreign records from U.S. branches of a bank. For example, in November, the federal appeals court in Atlanta affirmed a civil contempt citation and fines against the Bank of Nova Scotia for failing to produce Bahamian records.

A third weapon is international agreements pledging cooperation with U.S. criminal investigations. The U.S. recently expanded such an agreement with Switzerland and has been pressing several other governments, including that of the Caymans, to sign similar pacts. Some say the LeMire case has created an incentive for the Caymans to do so, or to quietly increase cooperation.

While there are tax and other advantages to banking in the Caymans, the islands' secrecy is thought to have drawn a significant amount of its business. Chicago attorney Buron Kanter, an offshore banking expert, says that if courts broadly follow the LeMire precedent, expectations of secrecy there would be eroded and, "I would think a lot of money would leave."

That remains to be seen; but it would be a blow. International banking in the Caymans has exploded since the islands tightened their bank-secrecy law in the mid-1960s. Richard Blum, chairman of a group that monitors offshore banking writes: "In 1964, the Cayman Islands had two banks and no offshore business. By 1981, the Caymans had 360 branches of U.S. and foreign banks, over 8,000 registered companies, and more telex machines per capita (population about 17,000) than any other country."

[Vanuatu is an emerging haven. An article from World Business Weekly, dated August 18, 1980 follows:]

VANUATU—THE TAX HAVEN NOBODY KNOWS

A roll call of names holding bank accounts in Vila would include practically all the financial top brass of Hong Kong, plus many thousands of major companies and rich individuals around the world. Many of them do not even know where the place is, but they do know that Vila, capital of the tiny South Pacific island group now known as Vanuatu, is one of the finer tax havens and loan-booking centers.

Most account holders do not worry about not being able to locate Vila on a map, although some may have been perplexed to learn at the end of July that their accounts had moved from the jurisdiction of the condominium of the New Hebrides (British section) to that of the sovereign state of Vanuatu.

The change came about because the group of islands and their 100,000 inhabitants won independence on July 30 after 75 years of dual colonial rule under the British and the French. In recent weeks the islands gained some publicity because of a bow-and-arrow rebellion on the largest island, Espiritu Santo, under the banner of Jimmy Stevens, who wanted to secede from the group.

Otherwise, after a comic-opera dual regime involving separate police forces, separate schools, separate courts, and separate legal systems, Vanuatu seems largely united under its properly elected government. The governing party, the Vanuaaku, is well organized and popular; it collected 68% of the vote on a 90% turnout in the election last November.

What it lacks is the police force and the cadre of administrators needed to govern the group properly. Those have been denied to the new government by British and French disagreement.

With independence comes the chance to win assistance from outside sources. At the same time, the government, led by Angelican priest Walter Lini, will be looking around for ways to raise revenue. The main export is copra, but the tax haven and loan-booking business will be at the top of the income-raising list.

The small brotherhood of bankers, trust company officials, and accountants who operate the tax haven are necessarily keeping a low profile for the moment but are ready to expand quickly if the Lini administration gives the nod. The participants have traditionally held to a soft-sell attitude for fear of embarrassing the British and French governments but would be only too happy to push Vila's merits harder.

The islands have long been seen by insiders as a significant, if small, loan-booking center. No figures are available locally, but other data show that at the end of 1979 banks and deposit-taking institutions in Hong Kong had placed at least $2.15 billion in Vila banks. Only three months before, the figure was $1.5 billion. Hong Kong is Vila's main client.

The South Pacific islands are also used extensively by Hong Kong residents as a means of avoiding Hong Kong's 15% interest tax. Offer a bank in Hong Kong a US dollar time deposit, and there is a good chance that bank will arrange to deposit it in a Vila account. As neither territory has exchange control, money can be moved easily and automatically, without penalty, and in most cases the books are kept in Hong Kong.

About 50 banks have New Hebrides licenses—and presumably will retain Vanuatu licenses—although only six maintain a physical presence in Vila. Four of these have been set up since Vila launched itself as a financial center in 1971. To complicate matters, the biggest bank in the islands, *Banque de l'Indochine*, has been operating under French law rather than under the British system that governs the offshore or "exempt" banking business. Banque de l'Indochine has no offshore business.

On the other hand, France's largest commercial bank, *Banque Nationale de Paris*, has no office in the islands, but is an active exempt bank. "Exempt" in this context means being free from the requirements on banks and companies carrying on domestic business within the islands. The *Hong Kong Bank* group has several exempt licenses as well as a local branch.

The Hong Kong connection may now be the dominant factor in Vila's financial picture, but it was not responsible for Vila's getting into the business in the first place. Tax-haven status derives from the British administration, which in 1970 decided to drape a legitimate cloak over the shoulders of some fringe financial venturers.

These money jugglers had caught on to the almost limitless possibilities lying behind the fact that the territory had no tax, no exchange controls, was outside the sterling area but used Australian as well as French currency—and had a dual legal system that in practice tended to mean no legal system at all.

So the British, with one eye cocked at the possibility of a new form of income for the tiny territory, created a formal basis for a tax haven. It was to be available only to the carriage trade, the uppermost crust of tax avoiders. Even today clients have to be introduced by respectable bankers, lawyers, or accountants, and currently there are only around 500 registered exempt companies—a relatively tiny number.

Five firms of international accountants—including *Peat Marwick Mitchell & Co., Coopers & Lybrand*, and *Price Waterhouse & Co.*—are active in Vila.

Vanuatu has moved with the times in providing bookeeping services. Since May of last year a satellite station has brought direct telex and telephone links. Counting up every little benefit that it hopes can be turned to its advantage. Vila also hopes o make better use of its time zone—an hour ahead of Sydney, two hours ahead of Tokyo, and a wide 19 hours ahead of San Francisco. Time-zone advantage could attrack banks in such areas as Asia to use Vila rather than the Caribbean to book borrowings.

Fees from the tax haven will help overcome the problems caused by 75 years of dual misrule, accented by the fact that although there were two systems for most areas, on Vanuatu there is no tax system at all.

Chairman ROTH. The subcommittee is in recess at 12:35 p.m. until tomorrow at 10 o'clock.

[Senator present at the recess: Senator Roth.]

[Whereupon, at 12:35 p.m., the hearing was recessed, to reconvene at 10 a.m. on March 16, 1983.]

CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES

WEDNESDAY, MARCH 16, 1983

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The subcommittee met at 10 a.m., in room S.D. 342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. William V. Roth, Jr. (chairman of the subcommittee) presiding.

Members of the subcommittee present: Senator William V. Roth, Jr., Republican, Delaware; Senator Warren B. Rudman, Republican, New Hampshire; and Senator Lawton Chiles, Democrat, Florida.

Members of the professional staff present: S. Cass Weiland, chief counsel; Eleanore J. Hill, chief counsel to the minority; Katherine Bidden, chief clerk; Rod Smith and Jim McMahon, deputy chief counsels; Chuck Morley, chief investigator; Tom Karol and Dave Glendinning, staff counsels; Tom McLaughlin, investigator; Glenn Fry and Leonard Willis, minority staff investigators; Sarah Presgrave, executive secretary to the chief counsel of the majority; Mitch Goldberg, Marilyn Milian, and Cindy Cappel, staff persons.

[Senator present at convening of hearing: Senator Roth.]

Chairman ROTH. The subcommittee will be in order.

[Letter of authority follows:]

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
Washington, D.C.

Pursuant to rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the chairman, or any member of the subcommittee as designated by the chairman, to conduct open and/or executive hearings without a quorum of two members for the administration of oaths and taking testimony in connection with hearings on Crime and Secrecy: The Use of Offshore Banks and Companies to be held March 15, 16 and May 24, 1983.

WILLIAM V. ROTH, Jr.,
Chairman.
SAM NUNN,
Ranking Minority Member.

OPENING STATEMENT OF SENATOR ROTH

Senator ROTH. Today we are continuing our hearings on offshore banking. Yesterday we had a number of witnesses testifying about the pervasiveness of the problem of offshore banking. I have to be very candid and say that I am deeply shocked by how this problem is growing and spreading.

We have a problem, not only with the corrupt organized crime using offshore banking as a means of laundering their ill-gotten gains, but the tragedy is that increasingly, a number of otherwise law abiding Americans are beginning to see this as a means of tax evasion. So that attacking the problem really goes to the very roots of our Government, of our fairness in the tax system.

Today we will be focusing on some specifics, showing exactly how these offshore banks and trusts function. I must say, this is the most interesting exhibit that this subcommittee has had since I have been chairman. It is not a bribe.

I was saying that it must be nice to have to weigh your money instead of counting it. But I think those funds represent something like nearly $3 million seized by our law enforcement officials. It typifies really the size and scope of the problem.

So I am very pleased to call before us today as our first witness the U.S. Customs Service Commissioner, William Von Raab, who is accompanied by William Logan, Director of the Financial Investigation Division.

Gentlemen, under the rules of the subcommittee, it is necessary to swear in all witnesses. Will you please rise and raise your right hand? Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Commissioner **Von Raab**. I do.

Mr. **Logan**. I do.

Mr. **Sidel**. I do.

Mr. **Corcoran**. I do.

Chairman **Roth**. Gentlemen, please be seated. Mr. Von Raab, you can summarize if you will, your statement or read it.

TESTIMONY OF WILLIAM VON RAAB, U.S. CUSTOMS SERVICE COMMISSIONER; WILLIAM LOGAN, DIRECTOR, FINANCIAL INVESTIGATION DIVISION; STEWART SIDEL, ASSISTANT CHIEF COUNSEL, CUSTOMS SERVICE; AND GEORGE CORCORAN, ASSISTANT COMMISSIONER FOR ENFORCEMENT, CUSTOMS SERVICE

Commissioner **Von Raab**. Thank you Mr. Chairman. First, I would like to introduce the other two gentlemen who are sitting with me. On my far left is Mr. Stewart Sidel, who is Assistant Chief Counsel for the Customs Service, who is responsible for all of our enforcement activities. On my immediate left is Mr. George Corcoran, Assistant Commissioner for Enforcement of the Customs Service and supervises all of the important activities of the Customs Services around the country.

Chairman **Roth**. Gentlemen, we are delighted to have you all here and appreciate your cooperation with this subcommittee. Please proceed.

[At this point, Senator Chiles entered the hearing room.]

Commissioner **Von Raab**. Organized crime is as much a business as petroleum, or steel, or automobiles. They need capital and so does organized crime. They need raw materials, so does organized crime. They need distribution systems, so does organized crime.

And organized crime—at least as much as any legitimate business—needs all the services and personnel that make for the success of any large enterprise. They need accountants, chemists, lawyers, pilots, and drivers. They want to enjoy the fruits of their crime, that is the money. So they need to be able to buy real estate and yachts, but most important, in order to make this whole system work, they need financial services.

As you are aware, it is the need for financial services that makes organized crime most vulnerable and that is directly attributable to the Bank Secrecy Act.

Just as the Sherman Antitrust Act has become the primary weapon for attacking abuses in the legitimate economy, so the Bank Secrecy Act has become the primary weapon in our campaign against organized crime.

One might say that—using the Bank Secrecy Act—we have been doing a little "trust busting" in the underground economy.

Our efforts to date have been directed primarily toward the narcotics trade, but the subcommittee should not lose sight of the fact that the Bank Secrecy Act—and all the enforcement techniques that we have developed—are applicable to most aspects of organized crime.

Where large sums of money change hands, there you will find the soft underbelly of organized crime, and that is what the Bank Secrecy Act enables us to attack.

That vulnerability was tested and proved in our effort to disrupt narcotics smuggling in Florida—some of you may know that operation by the title of Operation Greenback.

As a result of the Florida experience, we are deploying multiagency teams in various parts of the United States. Together they make up Operation El Dorado. They will use the same principles as Operation Greenback, but in addition to narcotics, they will be going after other participants in the business of organized crime.

As you know, the Bank Secrecy Act requires that international transactions over $5,000 in either cash or in instruments that are negotiable by the bearer, must be reported, as well as domestic transactions of more than $10,000, and the ownership of a foreign bank account.

Title 31 of the Bank Secrecy Act enables us to track those fugitive funds from one transaction to another until we are at the criminal's doorstep.

The Financial Law Enforcement Center at Customs is the Treasury Department's clearinghouse for intelligence on cash flow generated by criminal activity. The center collects and analyzes financial data, primarily cash transactions, and develops targets for investigation by task forces composed of agents from several different Federal agencies.

The Financial Law Enforcement Center provides a valuable service for Customs and the IRS, and other law enforcement agencies. For example, based on an analysis of currency transactions reported in 1981, we have identified what I feel is a startling statistic. Mr. Chairman, of all currency transactions in the United States involving amounts of $10,000 or more which were reported in 1981, 51 percent were made by individuals and companies with addresses in foreign countries. In fact, we were able to identify deposits of close to half of a billion dollars being made by individuals and companies from Columbia and Peru alone.

Not all of this of course is drug related, or even obtained criminally; however, I am personally amazed by the number of big dollar currency transactions made in the United States by non-U.S. entities. Primarily, this activity is taking place in Florida, New York, and California, and we are moving rapidly to target illegal activities which may be associated with some of these transactions.

With information such as this, as well as the valuable case analysis it performs, the Financial Law Enforcement Center, in my opinion, will prove to be one of the most valuable tools we have ever developed to combat organized crime.

The reporting requirements and the criminal sanctions contained in the Bank Secrecy Act have helped us map the route of colossal cash transactions—literally billions of dollars being shifted around the United States and beyond into foreign countries.

The Bank Secrecy Act presents the criminal with a dilemma that I can only describe as delightful. There he is with millions in small denominations. He can't spend it all at once or even gradually; the former would surely alert someone; the latter would take forever.

Think about trying to avoid the reporting requirements by limiting transactions to less than the statutory requirements—$5,000 internationally and $10,000 in domestic deposits.

We estimated that the value of the cocaine confiscated in one case was $75 million at the wholesale level. Imagine $75 million. It is approximately 25 times what we have in front of us here; $75 million would weigh almost 4 tons. That would be in street money. An individual would have to make 7,500 deposits in domestic banks to avoid the $10,000 reporting requirement, or hire a network of couriers to do so.

To avoid the $5,000 reporting requirement would take 15,000 trips overseas.

Our point of attack in financial investigations is not at the street level, it is several echelons higher—at what one might call the executive class of organized crime. To do otherwise would be like trying to close McDonald's, one store at a time.

Just as a point of interest, approximately 499 bills weigh a pound. That is in $100 bills, $1 million weighs 20 pounds, $1 billion, which is the street value of one seizure that was made of dope in Florida some months ago, would weigh 10 tons. That is 10 tons of money. So it is a real problem.

Senator CHILES. How much did the $1 billion worth of dope weigh?

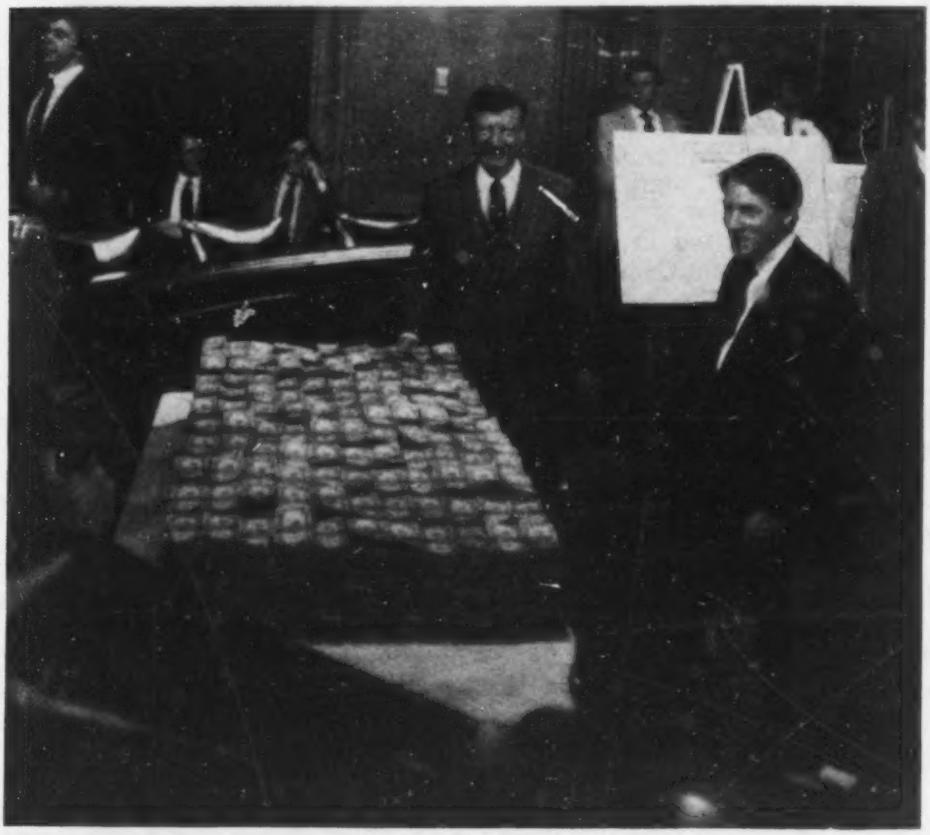
Commissioner VON RAAB. 3,906 pounds.

Senator CHILES. So it weighed approximately 2 tons?

Commissioner VON RAAB. Right. So I have always likened smoking or snuffing cocaine to doing the same thing with $5,000 bills.

For anyone who has never seen it, this is what $3.6 million looks like in $5's, $10's, $20's, $50's, and $100's. As a matter of fact, it is largely $20's, and $10's. So most street money, which this is, would actually be in greater bulk were it $3.6 million. For all intents and purposes, that money is useless in its present form. It cannot be spent. It has to be run through an elaborate process known as laundering, in order to obscure its original identity.

[A picture of the currency referred to above follows:]



The great bulk of this cash itself was, if not exclusively, then at least in large measure, actually transported from the hands of a drug dealer in the United States, into the hands of a drug producer in Columbia. It was sold by the Colombian drug producer to black market currency exchange with the obligation of making physical delivery to the exchanger's front company in the United States.

I would like to turn now to the actual money laundering scheme which resulted in our seizing this $3.6 million. This will give you an idea of the complexity of some operations, and of the utility of title 31, as we also refer to the Bank Secrecy Act. The scheme utilized a laundering method similar to that shown on the chart to my right, a copy of which you will also find attached to my testimony.

In April 1981, Operation Greenback initiated an investigation into the suspected money laundering activities of a highly complex organization based in Cali, Colombia, whose primary objectives appeared to be the transfer of enormous amounts of narcotics proceeds between Colombia and the United States.

This particular organization, known as Sonal, came to the attention of Operation Greenback after being targeted by the Treasury Financial Law Enforcement Center (TFLEC) due to the unusually large amounts of currency reflected on financial reports as having been transported into the United States from Colombia. From these currency reports, the Greenback agents in Miami, Fla., were able to identify the leaders of the organization as the Ghitis family, an important family in Colombia and Victor Eisenstein, their representative in the United States.

The Sonal Organization operated in much the same fashion as I have explained. The Ghitis family owned a travel agency in Cali, Colombia, where they operated a money exchange. In the operation of the money exchange, the Ghitis' purchased dollars in Colombia and caused these dollars to be delivered in their office in Miami and subsequently deposited in the Sonal account at a bank also in Miami. These dollars were then sold for Colombian pesos in Colombia, in the form of checks drawn on the Sonal account.

Investigation into the dealings of the Ghitis family with their Miami bank revealed that since the inception of the Sonal account, the deposits had been almost entirely cash deposits, made daily, in amounts ranging from $500,000 to $2 million. These dollars were primarily in denominations of $5's, $10's, and $20's, packed in paper bags, cardboard boxes and suitcases. The deposits were usually made by Eisenstein and were counted at the bank with a money counting machine purchased for the bank by Beno Ghitis.

In about June 1981, Beno Ghitis met with the president of his Miami bank. During this meeting the bank officer and Ghitis discussed the source and origin of the enormous amounts of cash being regularly deposited into the Sonal account. The bank officer told Ghitis of his suspicions that such amounts of cash could only have been generated by drug transactions, noting to Ghitis that Colombia is a source country for drugs. The bank officer expressed to Ghitis his concern over his bank's exposure under such circumstances. Ghitis denied that he was a drug dealer, however, told the bank officer that he suspected that the dollars he was purchasing could have been generated through drug transactions. At the time the Sonal account was opened, the bank charged a service fee of one-eighth of 1 percent of the total cash deposits each month.

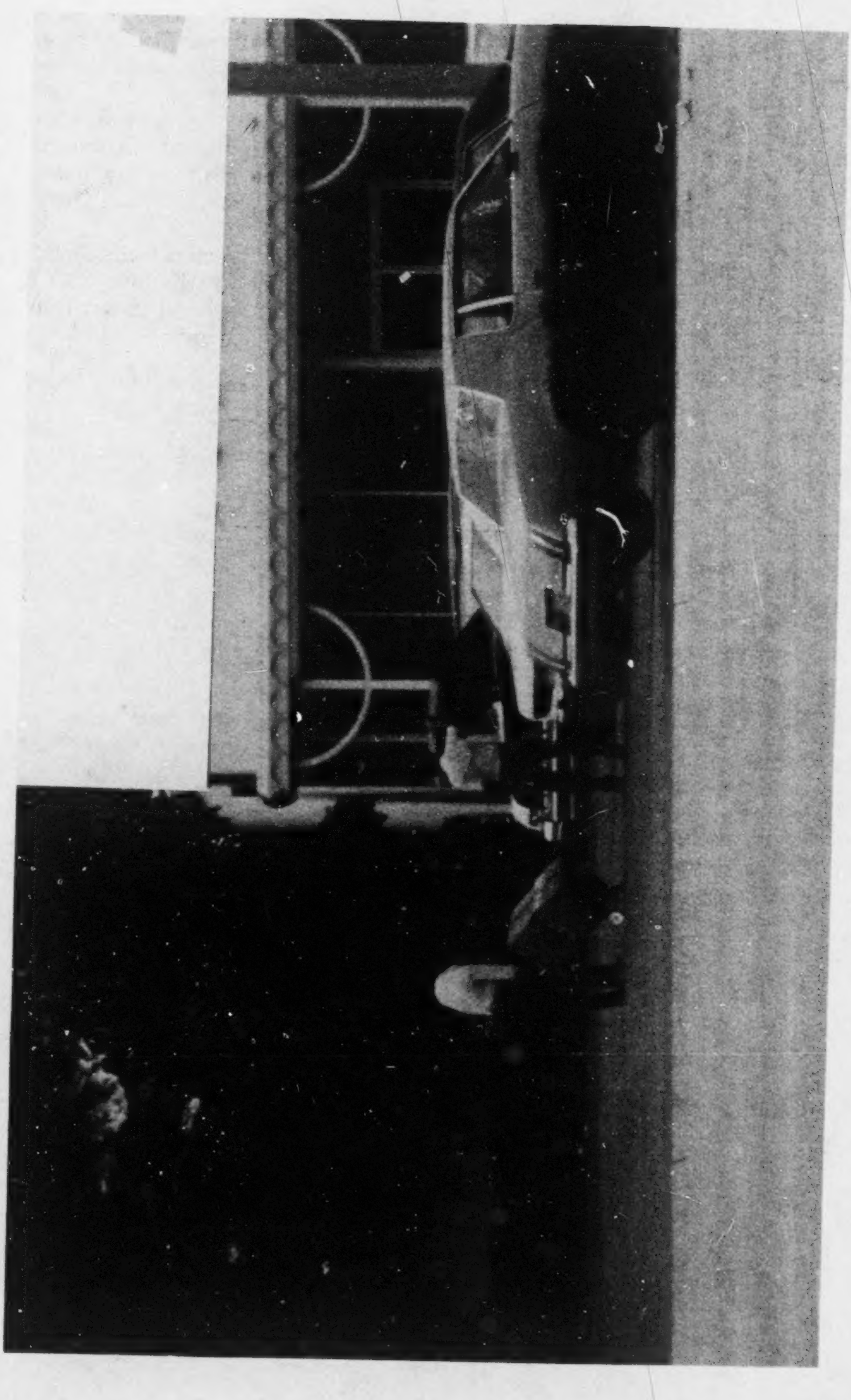
Imagine a bank charging a service fee to accept deposits. However, subsequent to this meeting, the bank increased their fee on the Sonal account to $300,000 per month. Annualized, this would generate a fee from Sonal to the bank of $3.6 million per year. The imposition of this fee was made retroactive to May 1981, and when Ghitis complained to the bank about the fee, he was told that the bank would immediately close the Sonal account if he—Ghitis—did not go along with the arrangement.

On August 16, 1981, customs special agents interviewed Eisenstein as he entered the United States from Colombia at Miami International Airport. At that time, the agents were successful in persuading Eisenstein to cooperate with the Government. As a result of Eisenstein's cooperation, an undercover agent was introduced into the Sonal office in Miami. He was allowed to listen to telephone conversations between Eisenstein and Ghitis, and was allowed to participate in the receipt of cash delivered to the office.

The Sonal office was also known as American Overseas Enterprises. It was scantily furnished and contained no security devices or safes for the storage of cash. On August 19–20, 1981, $7,012,799 in cash was delivered to the Sonal office by various Latin couriers who did not remain to count their delivery nor accept any type of receipt. The cash was delivered without security, in large brown cardboard boxes, grocery bags, and a Samsonite travel bag.

I have here a photograph, which is a surveillance photograph that depicts one of the deliveries being made. Note that it is in cardboard boxes. On the left is Victor Eisenstein and on the right is a courier known as Alberto. So you can see the informality with which these transactions are carried out.

On August 19, Eisenstein introduced the undercover customs agent to one Albert Rodriguez, who was in the Sonal office for the purpose of delivering over $2.5 million. The undercover agent assisted Eisenstein in removing the currency from Rodriguez' vehicle, which is what we see here in the photograph.



On August 20, 1981, Rodriguez, accompanied by another Latin male, again made a delivery to Eisenstein of over $2 million. The delivery was made in the same vehicle, a 1981 Chevrolet, which had been used the previous day. After this delivery, the vehicle was abandoned on a street in Miami Beach.

Subsequent to the abandonment, the vehicle was impounded and searched. Two Avianca Airline tickets to Colombia were found in the glove compartment. Additionally, the vehicle was found to contain a large, steel reinforced, secret compartment behind the rear seat which could only be opened by a switch hidden beneath the driver's seat. A certified customs narcotics detector dog was used to examine the secret compartment and the dog alerted to the scent of a controlled substance. One which had likely been transported in the compartment previously.

In many seizures of cash that take place, we find the cash from using narcotics dogs because the same individuals that are handling and counting the cash are often packaging or handling narcotics.

If I may call to your attention the particular chart, which is attached to my testimony, the chart was made up from Sonal records and bank records subpenaed during the investigation. It shows that during the period of January through August, an 8-month period, Eisenstein received in Miami, $242,238,739 as a result of Ghitis' transactions in Colombia with 29 Latin individuals. None of these individuals were found to reside or engage in legitimate business in the United States. These moneys were purchased by Ghitis in Colombia and were delivered in Miami by 37 couriers who, according to the records, were only identifiable through Latin first names or nicknames. These records also reflected that out of the $242 million delivered to Sonal, Rodriguez had delivered over $191 million in cash, purchased by Ghitis from a Carlos Molina. Molina is another Colombia money exchanger residing and doing business in Colombia. Molina, according to Customs and Drug Enforcement Administration sources is involved in narcotic trafficking.

On the evening of August 20, 1981, Beno Ghitis had a telephone conversation with Eisenstein which was monitored by a Customs agent. During that conversation, Ghitis told Eisenstein that Rodriguez knew that Eisenstein had been talking to Customs. Ghitis also told Eisenstein not to deposit any more cash into the Sonal account, but to place it in a safe deposit box until things cleared up.

During that evening, another Customs narcotics detector dog was used to examine the currency and containers which had been delivered to Eisenstein on August 19–20, 1981. The dog alerted to the residual scent of narcotics.

That night, the Customs agents seized $3,686,639 cash from Sonal. That is what you see on the table. On the following day, August 21, the agents sought and obtained a seizure warrant from the U.S. District Court in Miami for the moneys contained in the Sonal account, $5,325,954.88.

On August 24, 1981, the U.S. Customs Service in Washington, D.C., sought and obtained an assessment of civil penalty against Sonal pursuant to the provisions of the Bank Secrecy Act. A copy was immediately provided to an assistant U.S. attorney in the southern district of New York, who prepared and obtained a temporary restraining order enabling the attachment of $453,000 in a New York bank's Sonal account.

The action of the agents brought the total financial assets either seized or attached in this case to $9,465,593.88.

On November 17, 1982, the Honorable Judge Peter Beer issued a decision ordering the total forfeiture of the moneys seized. In his decision, Judge Beer concluded that the moneys seized were traceable to transactions for controlled substances and that in large measure, the money found its way to Colombia-based drug operators who sought to launder their cash by passing it through a money-exchange house.

On September 27, 1982, Beno Ghitis and Victor Eisenstein were arrested by Operation Greenback agents for violations of the Bank Secrecy Act. On November 24, 1982, both were convicted by a Federal jury on one count of conspiracy to defraud the United States and violate the laws of the United States, and on two counts of failing to report currency transactions. On January 25, 1983, the Honorable Judge Manuel Real sentenced Ghitis to 6 years in the custody of the attorney general and a fine of $610,000 and Eisenstein to 4 years in the custody of the attorney general and a $210,000 fine.

At the outset, I said that organized crime is a business. As I stated recently in an article I wrote for the Washington Post:

> Drug smuggling is a business, big business, and it does not exist in a vacuum, it exists side-by-side with legitimate businesses. And at the fringes of the drug trade, it is sometimes difficult to distinguish the honest from the dishonest.
>
> But what of the business who doesn't hear alarm bells when a customer pays for a product or a service with large amounts of cash? He is either disingenuous or not long for the business world. In either event, he has made the drug business his business, and morally he is as corrupt as the drug pusher on the street—Drug business is everybody's business.

Thank you.

Chairman ROTH. Thank you. In your opening statement you commented on how difficult it is to attack the basic criminal organization and very frankly that has been one of my principal concerns even though we put some people behind bars and are very successful in many cases. I want to congratulate your group for the tremendous job that they did in the Sonal case. I think it is an outstanding example of successful law enforcement.

But the thing that concerns me so much is that despite this kind of success, we find it almost impossible to destroy the criminal organization itself. Let me ask you in this particular case. What exactly happened to Sonal? Is it still functioning the same as ever?

Commissioner VON RAAB. Not the same as ever. Do you want to characterize that?

Mr. LOGAN. I believe I can. The easiest way to characterize it, I believe would be prior to this particular occasion, the size of deposits did range from anywhere from $200,000, $500,000, $2 million a day. Since that particular time, although the certain segment of the business has remained in operation, the amounts are in the 10, 12, $13,000 range.

Chairman ROTH. So at least in this instance we feel that the organization is not involved in this illicit activity? Or at least on a major scale?

Mr. LOGAN. That is correct. I believe we penetrated deeply enough to stop it.

Chairman ROTH. You were a leader in Operation Greenback, were you not?

Mr. LOGAN. Yes; I was one of the supervisors.

Chairman ROTH. I want to congratulate you for that role in that activity.

Mr. LOGAN. Thank you sir.

Chairman ROTH. If I recall, you say this one organization, in a period of 8 months, was laundering something like a quarter of a billion dollars?

Commissioner VON RAAB. That is correct.

Chairman ROTH. One of the things that concerns me is, I don't think the public is really aware of the dimension of this problem This is really a small example of the problem, is it not?

Commissioner VON RAAB. That is correct. There are estimates running somewhere between $50 and $70 billion of money that is used in the narcotics business, $50 to $70 billion. So this is just a very small part of that. But nevertheless, it is a significant organization.

Chairman ROTH. I agree with you that one of the most successful ways of attacking the problem is to take the profits out of it and its money. It is the ability to launder this corrupt money that has made organized crime or these kind of functions so successful. If we can stop that, then we may strike a significant blow against much of organized crime. Do you agree with that?

Commissioner VON RAAB. Yes. The approach that is being taken here, which is a joint Customs-IRS approach, I cannot say it is novel because the Bank Secrecy Act has been around since 1972. I guess 1970. However, it is only recently that the Internal Revenue Service and the Customs Service, in this joint operation have begun to use all of the benefits of the Bank Secrecy Act in this area. So we look forward to increasing success in attacking the assets or the soft underbelly of the organized crime world.

And in this respect, Customs and IRS will be very active in the Presidential Drug Organized Crime Task Forces around the country in working this part of the attack on organized crime.

Chairman ROTH. Let me just for a minute, go back to the figures. As you mentioned, the case of narco-bucks, we could be talking about some guesstimates, that is what they are, as much as $70 to $80 billion.

Commissioner VON RAAB. That is probably a little high. I think it is probably closer to $50 to $60 billion.

Chairman ROTH. Small business.

Commissioner VON RAAB. Right.

Chairman ROTH. But even accepting that figure, or half of that, as I understand it, that is just the tip of the iceberg because you not only have money being laundered through these offshore banking systems from narcotics, illicit narcotics, but you have the same problem with all kinds of organized crime activities as well as the fact that even some legitimate money is going offshore, apparently to avoid taxes. Do we have any guesstimates of what we are talking about there?

Commissioner VON RAAB. I do not have an idea of how much is leaving the country just to avoid taxes, but I can tell you that since 1978, the Treasury Financial Law Enforcement Center just in its initial reviews and primarily over the last year or so, has identified over $4.7 million of suspect transactions. So it is in the billions of dollars certainly in terms of the drug activity and I would hate to guess how much is leaving the country to avoid taxes, because there are obviously more people involved in that activity than there are in the drug world.

Chairman ROTH. It is a sad fact that, I guess, fully legitimate businesses are involved in the same dollar amounts. Of course, the problem with laundering this money, bringing it back, is much of this money conceivably could be finding its way into legitimate businesses, so we have a takeover of legitimate businesses by this corrupt money.

Commissioner VON RAAB. Oh, yes. There is no question but that certainly foreign interests have acquired interests in the United States and the assumption would have to be that the money they have used has been acquired through trafficking drugs in the United States, moneys brought out, then brought back for investment. That is why it is brought back.

Chairman ROTH. In your closing remarks, you made some comment about business people accepting this money without questioning it. This raises a question of ethics. I think that raises some very tough questions on more than one side. But it bothers me. What kind of bank would accept this kind of money? For example, do State banks show the same scrutiny that federally chartered banks or are special banks created for this purpose?

Commissioner VON RAAB. I think it would be difficult to distinguish between State and Federal banks. I think that the bank that would be most likely to accept this kind of money would be one that would be controlled by some foreign criminal interest. Obviously they would take it. A bank in trouble might take it. We were nervous a while back when the savings and loan associations were having a hard time. Fortunately, the economy has snapped back a little bit and the savings and loans are now feeling a little safer. We saw some money that was possibly going to be moved into those banks because they were desperate. Badly managed banks will receive some of this money because the management is not properly controlling the activities of its employees. But it is very difficult to say that it would be more likely at State bank versus a national bank. It is really the character of the individual bank, whether it is well managed, whether the management is tainted in any way by criminal activity and in some cases whether the bank is desperate to get some money in to it.

Chairman ROTH. Let me go back to your basic propositions. I go into a bank with $10,000, I probably would be a little unhappy if I felt they would begin questioning me as to where I secured the money. Where does the obligation of the individual bank begin? Are you saying it is just occasional, or are you suggesting that when they continuously come in with these——

Commissioner VON RAAB. The bank is obligated to file a form with the Federal Government whenever it receives a deposit of $10,000 or more in cash or negotiable instruments.

Chairman ROTH. That does not go into words. Let us say I deposit—let me make sure I understand what you are saying. If I come in with $10,000, they have to make a report?

Commissioner VON RAAB. That is correct.

Chairman ROTH. Do they have to ask where I secured that money?

Commissioner VON RAAB. No. They ask who you are, where you live and certain identifying items, social security number, matters like that. I forget. What else? That is all.

Chairman ROTH. Is not the problem more where the same person keeps coming in with cash or is it?

Commissioner VON RAAB. The same person will come in with cash, but what you will discover is, the problem is the bank account has 37 depositors and maybe even more. That is the tough one.

Chairman ROTH. Say that again, please.

Commissioner VON RAAB. The problem is not necessarily having the same guy come back with the case, but the problem is when a bank has 37 depositors in the same account, all of whom come in with cash.

Chairman ROTH. I see. Is there any problem with other financial institutions? For example, we held some hearings last year on fraudulent schemes by a Florida commodities boilerroom operation. They operated all over the country. There was some testimony that showed that there was a commodity fraud scheme in some Florida boilerrooms that were engaged in laundering drug money. The question I am asking is, is it only banks or other kinds of institutions that are involved in this kind of laundering?

Commissioner VON RABB. Any institutions that would, in the normal course of business, handle large amounts of cash, can be involved in laundering. It could be a company that exchanged foreign currency for U.S. currency. They have a good reason to have a lot of cash on hand. It could be a savings and loan institution. It could be a large bank. It could be a gambling casino. It could be any sort of an organization that normally handles large amounts of cash.

Chairman ROTH. Have you any evidence that this laundered money is finding its way into legitimate business? Is there any significant problem with these criminals taking over or at least buying into legitimate business?

Commissioner VON RAAB. Of course. As I indicated in my statement, the purpose of these drug traffickers is not just to collect cash and to keep it under their mattresses. They want to take this cash and not only enjoy themselves by buying boats and big houses, but they also, just as we have seen with other organized crime activity, buy themselves into legitimate activities. So, of course, a large amount of this money must be finding its way into legitimate activities. We have a number of those cases under investigation. We do not have any more specific information that we can give you at this time.

Chairman ROTH. I guess the problem is trying to trace that money. Once they get it overseas into a haven, then the cloak of secrecy is very hard, I suspect, for you to penetrate.

Commissioner VON RAAB. There is no question that the so-called tax. or we could call them now cash havens abroad, cause a real problem for the Federal enforcement officials to trace transactions. That is one of the major problems that we have in dealing with this issue.

Chairman ROTH. What about the problem of individuals taking legitimate money overseas? Are you involved in that kind of investigation?

Commissioner VON RAAB. You are obligated to report to the Customs Service if you are exporting or importing more than $5,000. So we have information that we compiled and review with respect to the exportation of cash and importation of cash. If we see any questionable or obviously illegal activity related to that, we will begin an investigation along with the IRS.

Chairman ROTH. One of the criticisms one hears is that Customs, for a number of reasons, is somewhat reluctant, except under the most, I guess, gross violations, to stop individuals. The individual stopping somebody leaving the shores with a suitcase of money, if he is wrong, he could be sued. What are the problems in this area from the standpoint of law enforcement?

Commissioner VON RAAB. Law enforcement has its problem with respect to any action it would like to take. I mean it is grappling with the issue of ordered liberty. The Customs Service is not happy to be interfering with legitimate travelers who are leaving the United States under the authorities that we now have, we feel that we need pretty good reason to stop or question anyone who would be leaving the United States. And for that reason and our unwillingness and our belief that we should not act without pretty good reason to stop somebody, it probably is a little easier than it should be to leave the United States with cash. If we had a little more support from legislation in that area, we could feel it was the American peoples will by virtue of the legislation, we would probably be much more aggressive in searching outbound passengers.

Chairman ROTH. As you know, I have been pushing legislation to change the standard from probable to reasonable cause. Would that be helpful?

Commissioner VON RAAB. That would be very helpful to us.

Chairman ROTH. What bothers me is the stories one hears. A lot of these people come to the United States with suitcases of money and buy condominiums and other expensive items. That is the last you hear of that money.

Commissioner VON RAAB. Those are the penny ante types. Many of them are leaving with cargo bays full of money as well. We have the same problems with respect to that.

Chairman ROTH. I guess my concern with that kind of a case is that the more widespread it becomes, the more difficult it becomes to enforce our tax law at home.

Commissioner VON RAAB. Yes.

Chairman ROTH. I think we have already got the perception among the public that many people are not paying their fair share. That is what feeds on itself.

Commisioner VON RAAB. In fact, the illegal practices have a habit of catching on.

Chairman ROTH. I am considering amendments to the Bank Secrecy Act which would make violators of that act the basis for court ordered wire taps. Would you favor that?

Commissioner VON RAAB. Yes. We would support that strongly. Wire tap authority would be extremely helpful in this area.

Chairman ROTH. We are very pleased to have Senator Chiles here today. Senator Chiles.

Senator CHILES. I am delighted to be here to participate in these hearings and I want to congratulate you and the majority in setting these hearings up. Mr. Commissioner Von Raab, we are delighted to have you here today. Operation Greenback is something that we consider a real success story. It begins to give some kind of hope and heart to people in Florida that the Federal Government is going to get its act together and try to give some help and assistance. I remember when I first started listening to some law enforcement officers in Florida in early 1981, talking about the fact that a team was being put together by using Customs agents and IRS agents and some strike force people all making a coordinated effort. Certainly, the results have been very, very positive.

In the particular case that you talked to us about today, were the proper reports made by the bank under the Bank Secrecy Act? Are we talking about an instance in which reports were made and yet the bank seems to know it was large transactions or were reports not made?

Commissioner VON RAAB. Some reports were made and actually it was the review of those reports that initially led us to the case. It would be hard to say that all the proper reports were made. But our Treasury Financial Law Enforcement Center analysis, operating with Greenback developed the initial information that led us to attempt to penetrate this organization.

Senator CHILES. But it was from the basis of reports that were made that triggered you onto this particular operation?

Commissioner VON RAAB. That is correct.

Senator CHILES. Did you have any cooperation from the bank in regard to the investigation? Did you seek that?

Commissioner VON RAAB. No. I am not saying they refused to cooperate.

Senator CHILES. You were operating on another basis.

Commissioner VON RAAB. We acted independently of the bank in this case.

Senator CHILES. You have cited the conversation that took place between the bank and Beno Ghitis, who met with the president of the bank. Has that conversation ever been gone over with the bank itself, the president of the bank?

Mr. LOGAN. Senator Chiles, the comments made, or statements made here, were from Findings of Facts made by the judge in this particular case.

Senator CHILES. They were findings made by the Judge?

Mr. LOGAN. Conclusions of Law made by the judge as well as testimony from Mr. Ghitis himself during the trial. Whether they had talked to the bank or not, I think I would rather not comment on that at this time. That matter has been referred to Justice for their action.

Senator CHILES. That is what I was interested in. That matter is still pending?

Mr. LOGAN. Yes. It is.

Senator CHILES. I shall not go further into that.

We have heard many times that the examiners, which are not under you, but the bank examiners themselves, often gain information through their activities, or in their examinations—come across large instances of cash. What kind of cooperation are you receiving now? Have you built any kind of protocol between the bank examiners who are under the Controller of the Currency and your task force in regard to areas that they come across?

Commissioner Von Raab. There are two types there. We have got the Federal Reserve Board on the one hand and the Controller of the Currency on the other. The Federal Reserve Board has been very helpful with us, with respect to general information, amounts of cash flow moving from one area to the other. That is very helpful to us to target general developments; for example, banks take in and issue cash. That is where you get your money from the Federal Reserve Board.

If you look at the figures in Miami, you will, much to a banker's surprise, see that the Miami bank receives much more cash than it gives out. For example, I think they show cash surplus of $3 to $4 billion, whereas in New York, the Federal Reserve district would show a cash deficit of some $4 billion. So those sorts of pieces of information from the Federal Reserve Board are very helpful.

With respect to the Controller of the Currency, I speak regularly to Todd Conover, who is the Controller, and we have a good working relationship between the two organizations, and receive any numbers of helpful hints from them. However, there are certain restrictions placed upon the Controller's Office by virtue of various Privacy Act provisions, and therefore we obviously do not have unlimited access to information that they develop. But any information that is able to be made available to Customs and IRS legally, we receive and we receive it with good cooperation.

Senator Chiles. I think the subcommittee would probably like to have, from you or from your legal department, a memo on any problems that you are incurring under the Privacy Act, so that we can examine those and determine whether that was something that we intended to cover in the Privacy Act or is this another problem that we have created in the passage of the act? It took us 3 or 4 years to repeal a provision that the IRS interpreted to say that even when they came across the commission of the crime in their routine audit, that they could not disclose that information to Justice or any law enforcement agency, and we got into a catch 22 situation: Unless the specific question was asked that particular person and with such specificity that no one—not knowing what IRS would know—would know how to answer that kind of question.

If we have got that same kind of situation that is prevailing with the Controller of Currency and with the bank examiners or with the Federal Reserve, I think we need to know about that.

Commissioner Von Raab. We would be happy to provide you with a paper.

Senator Chiles. An individual's privacy is something we very much want to protect here. But we are not trying to protect criminals from being disclosed, or criminal activity on the basis that someone is dealing under the Privacy Act. We definitely need to know about that.

Commissioner Von Raab. That would be very helpful and we will be very happy to provide you, and I will also speak with the Controller of the Currency as well.

Senator Chiles. Prior to the time that Operation Greenback sort of got underway, in spite of the fact that there was the Bank Secrecy Act and the other reporting requirements, there was very little enforcement on the part of Customs and on the part of the other regulatory agencies on the banks to see that they were complying with those requirements. It sort of became customary practice, a very lucrative customary practice I think, on the part of the banks that they could take in large amounts of cash in south Florida and not report it, and that there was not anything wrong with it. Nevertheless, as you said at the end of your statement, it was in the normal course of business and we needed to do something about that.

With the initiation of Operation Greenback and even before that, Customs began to crack down and began to do something about that. I wanted to ask you. What is your feeling now? Are the banks now complying with the reporting requirements? Has the situation changed where people could take laundry bags full of money, go into the bank, turn that bag in, deposit that money and begin their laundering operation? Are the banks cooperating now and has that business as usual changed?

Commissioner VON RAAB. In order to answer that question——

Senator CHILES. I do not mean to include all banks.

Commissioner VON RAAB. Financial institutions. There are two types of financial institutions, obviously legitimate well run organizations and those that have some criminal penetration, which are very few in the latter case. I think it is fair to say that the legitimate first class financial institutions, to some degree, were not aware of the importance of this reporting information to the Federal Government. Over the past few years the Customs Service and the IRS have made a tremendous effort to bring this to their attention.

I actually appeared once before the Florida State Banking Association and brought it to their attention; I guess they got a little angry at me. But I have to say that the compliance level among the good institutions now is very good. So there is no lax attitude on the part of those organizations to their requirements. You are never going to have good compliance from anyone that has any criminal penetration.

Senator CHILES. What are we doing about those in which there is not cooperation or in which there is criminal penetration?

Commissioner VON RAAB. We have investigations into a number of those cases.

Senator CHILES. Have there been any cases that have been brought to date?

[At this point, Senator Rudman entered the hearing room.]

Commissioner VON RAAB. On compliance?

Senator CHILES. On compliance or criminal penetration. I know there has been some change in ownership in several banks that were penetrated. I assume that that change in ownership did divest those people, a couple of the banks I know were taken over by the drug dealers.

Commissioner VON RAAB. There have been, I guess, at least a few indictments over the past year or so. It is fair to say that we have a number of investigations underway with respect to that. Strictly speaking, the responsibility for insuring that the banks are in compliance is the Internal Revenue Service's responsibility, but we work together with them.

So people that are, strictly speaking, responsible for the poor compliance of the banks are the Internal Revenue Service, but I am aware of and the Customs Service is cooperating in a number of investigations in certain cases in which we feel that compliance is low and particularly in Customs perspective, where there would be criminal activity.

Chairman ROTH. Thank you Senator Chiles. I have one further question. One of my concerns is that as we build these reporting requirements that they form an effective basis of action on the part of our law enforcement people. Right now Congress is wrestling with the problem of withholding. IRS is saying that they get so many forms they are not able to really police them. My question to you is, are you afloat with some of these forms, reporting that $10,000 or higher funds are being deposited so that it is almost impossible to review and screen those for the illicit ones?

Commissioner VON RAAB. The answer to that is, we are afloat with a lot of forms and the Customs Service is responsible for processing these. There are three types of forms. The two important ones are the bank deposit forms, and the border crossing forms. The Customs Service has all of the pertinent information on the bank deposit forms in a large computer with which we can access and massage, play with the various programs. We are about 1½ months behind in actual real time.

Nevertheless, from the day that you would file a form or actually, the bank would file it on your behalf, it would make it into the database. We are somewhere between 1½ months and 2 months behind. I think from Customs standpoint, that means we are a month too far behind, because it takes about 13 days to collect these since they are basically packaged on a monthly basis. With respect to the Customs forms themselves, that is the ones that are handled in and filled out by the passenger at the border, we are only a few days behind. So those are actually right up to date.

So I think to say that the information is in the computer, it is timely, we have programs that are able to select and do studies within the computer that will enable our agents to target organizations and to go out and begin particular investigations. For example, last year we produced over 200 analytical reports and we developed what we thought were 14 major targets reflecting over $50 billion in activity. That is the sort of information that we are developing and we expect that sort of activity to continue to develop and increase.

Chairman ROTH. Gentlemen, again I want to express my appreciation and congratulations for the success you have had. We want to continue to work with you in this particular area. I think it is important that we develop forms that are useful and not so heavy in number that they bog you down in detail. Thank you very much.

Senator CHILES. Mr. Chairman, if I might ask one more question.

Do you have any recommendations for any change or further change that you think should be made in regard to the provisions that allow you to seize or forfeit in regard to these cash situations? I know that there were some problems in making arrests of people that were getting on board airplanes with tremendous sums of money and then being able to seize that at the time you made the arrest. I know there are all sorts of provisions, problems with regard to forfeiture.

Commissioner VON RAAB. The answer is yes, we do have problems and we would like our outbound search authority strengthened and there are some provisions that we have prepared within the Department of Treasury. I am aware that Senator Roth has some as well. We would support the strengthening of those outbound search reports.

Senator CHILES. I would appreciate hearing from you on what you think are the changes you need in that.

Commissioner VON RAAB. At the same time that we give you the information on the problems, if any, with the Privacy Act, we will be happy to submit to you those strengthening items that would be helpful to us in the outbound search.

Chairman ROTH. I would urge you to do that rapidly, because we do have the legislation that the Senate acted on and if we want to make further recommendations we need your recommendations.

[The information subsequently received by the subcommittee follows:]

THE COMMISSIONER OF CUSTOMS,
Washington, D.C., July 1, 1983.

Hon. WILLIAM V. ROTH, Jr.,
Chairman, Senate Permanent Subcommittee on Investigations, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: During my recent appearance, I agreed to provide you with additional comments relative to the availability of information from the bank supervisory agencies and legislative proposals that will enhance U.S. Customs ability to enforce the Currency and Foreign Transactions Reporting Act.

As previously discussed there are some statutory and regulatory limitations that encumber the free flow of certain enforcement information from the various bank supervisory agencies. Since your hearings, the Department of the Treasury has undertaken an active review of this entire situation and will soon be in a position to make specific recommendations to enhance the flow of such data necessary to ensure optimum enforcement of the provisions of the Act. When this review is completed, I am confident the Secretary will provide this committee with a summary of its findings.

Also, you will find enclosed specific legislative proposals designed to improve U.S. Customs enforcement abilities relative to the international movement of illicit monies. These proposals have, in part, been incorporated in the Administration's latest crime bill S. 829 and H. 2151 (see sections: 420, 423, 1201 and 1604). In addition, Customs will be submitting additional proposed amendments shortly. These proposed amendments are still undergoing internal Treasury and Justice review.

If I can be of further assistance, please do not hesitate to contact me.

Yours faithfully,

WILLIAM VON RAAB.

Commissioner VON RAAB. We really appreciate the support of the subcommittee in this area, because we believe it is the No. 1 tool that we can use against organized crime.

Senator CHILES. Very much so.

Commissioner VON RAAB. The more authority we have in this area, the more helpful it is.

Chairman ROTH. Thank you, gentlemen.

Our next witness is Beno Ghitis, a Colombian citizen, who has recently been convicted of currency violations and conspiracy in Miami. He is prepared to discuss the method used to collect the quantities of currency displayed here this morning, however he continues to insist that he did not intend to violate U.S. law. I would point out that the money, the currency in front of you was seized from the operation that he managed.

It is my understanding, and we will accept a prepared statement that he submitted to the subcommittee earlier, but that he has since then revised it in some particulars and he will be so testifying prior to the questioning.

Mr. Ghitis, if you will remain standing, you will have to be sworn.

Would you raise your right hand?

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. GHITIS. I do.

Chairman ROTH. Please be seated.

Prior to your testimony, I would ask your attorney to identify himself.

Mr. TATE. Yes.

My name is Freeman Tate, associate attorney with the law firm of Brayman & Tate.

I am here to assist Mr. Ghitis in his testimony.

Thank you.

Chairman ROTH. Mr. Ghitis, I would at this time ask that you summarize your statement, your complete statement will be put in the record as if read.[1]

TESTIMONY OF BENO GHITIS-MILLER, CONVICTED COLOMBIAN MONEY EXCHANGER, ACCOMPANIED BY FREEMAN TATE, ASSOCIATE ATTORNEY

Mr. GHITIS. Thank you, sir.

My name is Beno Ghitis. I am a Colombian citizen. I am presently serving 15 years for violations of U.S. currency reporting laws of operating a financial institution.

My family in Colombia has been in the currency exchange business for 20 years. I took over that business from my father in 1978. Prior to that, I had been manufacturing hi-fi systems in Colombia. I have a bachelor's degree in chemical engineering, a master's degree in computer science, and had done partial work on a doctorate.

Generally the currency exchange business performs two kinds of transactions. One is the sale and the other the purchase of foreign currencies. For the Colombian, the dollar is not only a foreign currency; it is a commodity.

A purchase of dollars is done when the Colombian exchange house acquires dollars from a customer, paying him in pesos. A sale of dollars is done when the exchange house delivers dollars—a check in dollars—to a customer, receiving from him, pesos.

Our exchange house, hereafter referred to as Sonal, was licensed by the Colombian Government to trade dollars. It was one of the largest exchange houses in South America. In 1978, when I took over, the number of exchange houses in Colombia moving in excess of $500,000 a month was around 20. The number of small exchange houses was in the thousands.

At that time, we were exchanging around $2 to $3 million dollars a month. By the middle of 1981, we were averaging $35 million a month. In fact, we were so large and reputable, that most of the banks in Colombia, and many all over South America, were buying their dollars from us.

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[1] See p. 300 for the prepared statement of Beno Ghitis-Miller.

Our sale transactions were limited to Colombia. We sold dollars in cash, or as checks against our accounts in the United States. Our purchase transactions were more elastic: We purchased dollars which were either delivered to our office in Colombia or to our accounts in other countries, especially the United States. The payment, however, of the pesos, was always done in Colombia.

We purchased also checks in dollars in Colombia. However, due to trouble with bad checks, and people complaining about long transit time, we started to request the customers, when the amounts were large, to have the checks cashed in the United States, and the currency delivered to our accounts.

There are many reasons for the growth of the black market of dollars in Colombia which lead to the proliferation of exchange houses.

On one hand, the Colombian Government imposed, 15 years ago, heavy restrictions on the exchange of foreign currencies, which centralized all transactions through the central bank, called the Banco de la Republica. However, when drastic changes in the international situation in the 1970's demanded corresponding changes in these policies, the Government limited itself to the adoption of superficial measures, which only caused the diversion of huge amounts of dollars to the private market.

Another reason is the fact that the national sport in Colombia is to cheat the Colombian Government. As opposed to the developed countries where citizens see a high percentage of return of taxes paid, in the form of roads, hospitals, police protection, et cetera, the Colombian citizen knows that the moneys paid to the Government are generally misspent, and go either into some politician's pockets, or are wasted in useless multimillion dollar public work schemes.

It is estimated by official sources that as much as 50 percent of the Colombian economy is underground. In addition, to this, only about 10 percent of the population have bank accounts, either because they are illiterate or they don't trust banks and checks. Indeed, the handling of substantial amounts of currency is part of the Colombian way of living.

The rates of exchange of my business was between the rates of the Banco de la Republica. One of the policies adopted in the seventies by the central bank was to discount from 7 percent to 11 percent in the exchange of dollars to pesos, as an anti-inflationary measure.

For instance, if the official rate was 45 pesos per dollar, the Banco de la Republica would be buying at 42. I, however, was able to offer 43 pesos for a dollar. And, while I was selling at 44 pesos for a dollar, the bank was charging 45, the official rate. Hence, we always offered better rates on both ends, than the Banco de la Republica.

In 1979, the Banco de la Republica moved to absorb dollars from the black market and benefit from the large differences between the buying and selling prices. This activity was—and still is—known as the sinister window of the Banco de la Republica. This window allowed any person to sell dollars to the Banco de la Republica without limitations as to the amounts and without presenting any identification. This measure did not affect my business because of our rates and due to the fact that the bank buys dollars only if physically located in Colombia.

As explained, one end of the business was the sale of the dollars, the checks in dollars that we sold against our accounts in the United States were used by our customers mainly for purposes of importing goods to Colombia, to transfer capital in pesos to the United States, et cetera.

The Colombian business has therefore to buy a check in dollars. If it doesn't have a license to import the merchandise, however, it cannot buy these dollars at the Banco de la Republica; it has to apply to an exchange house like ours.

The other end of the exchange business is the purchase of dollars.

There are many sources from which a money exchange house can purchase dollars.

One of these, and apparently the only one which the U.S. Government is able to understand, is drug smuggling. There are, however, many other sources. Some of them, from which we certainly purchased the dollars we exchanged, are herein described.

It is common for Colombians in the United States to send money to their family in Colombia. Most of these moneys used to be sent mainly in currency or checks through the mail. With the appearance of many small one-person exchange businesses in the United States among the Colombian communities, many of those moneys were delivered by the relative to the exchanging person in the United States, who ordered his agent or office in Colombia to pay the pesos to the intended payer. These small exchanges in the United States then sold their dollars to bigger exchange houses in the United States in order to secure again pesos and complete the cycle.

Another source of dollars is the transfer of undeclared international capitals to Colombia by investors that sought to take advantage of the small and stable declaration of the Colombian peso, which, coupled to the high bank interests, returned a net interest of 20 percent and more in dollars.

A third and the major source is the illegal or undeclared exportations of conventional products from Colombia.

The Colombian income taxes on declared exportations, the low rates paid for the dollar by the official bank, and the international and domestic quotas for exportation set on many products are all reasons the exporter has to consider when declining which portion of his exportation he is going to declare and which he is not.

I have compared the official figures of the foreign trade of the United States and Colombia for 1980 and 1981. It was not a surprise that the United States consistently reports a value for all the importations made from Colombia, which is 35 percent higher than the figures the Colombian Government reports to have exported to the United States.

I believe the actual difference should in fact be higher, for the U.S. records do not show, of course, the values of conventional products actually smuggled into the United States—like emeralds—nor the eventually underbilling requested by the American importer to reduce its custom's duties.

[At this point, Senator Roth withdrew from the hearing room.]

Mr. Ghitis. A typical example of a source of dollars would be an exporter in Colombia sending $2 million of coffee to the United States but declaring only $500,000.

Our office in Colombia, after agreeing at an appropriate rate, would direct him to have the dollar delivered in currency to our bank accounts or our office in the United States.

As soon as we receive confirmation of the delivery of the currency we issue the pesos to the Colombian exporter in Colombia. Prior to 1980, the deposits in our accounts in the United States were performed directly by the representative or agent of the customer.

In 1980, my business had grown to such a degree that I hired an agent in the United States to receive packages and notify us of the currency deposits.

This office operated on the fourth floor of the bank we were using. By 1981, 90 percent of the dollars purchased by Sonal were delivered to the office in Miami. In fact, the largest portion of the currencies purchased by us came from exchange houses having agencies in Miami.

The operation of one of them had grown along with Sonal over the last year. It was at the top of a large pyramid of moneychangers operating in the Colombian communities throughout the United States.

However, it didn't have the history or reputation of the Ghitis family which allowed Sonal to sell in the form of personal checks in dollars any amounts all over South America.

Sonal's business doubled in volume each year under my management. In the last 8 months of operation, prior to being closed by the Government, we had exchanged $250 million to pesos. Most of that amount was received in cash in our Miami office. Records of all transactions which we kept under the advise of an attorney were delivered later to the Government.

In March 1981, we applied to the IRS through the chairman of the bank in the United States for a meeting in which we sought to open our business to the Government and seek advice as to what forms we needed to file to fully comply with the laws of the United States.

IRS sent us back a message that Sonal was OK. In fact, it was later discovered IRS had told Capital Bank that they would get to Sonal when they are ready for Sonal.

In August of 1981, the Government approached Sonal and requested to open a money laundering scheme in the Government for the office of Sonal. We refused to do so. Some days later, our accounts were seized by the Government on charges that Sonal's moneys were transported from Colombia to the United States without filing the appropriate forms.

One year later, during the litigation of the civil case, I was charged, later convicted on the basis, on the Sonal records that I had supplied in the civil case under the court orders for violating the used currency reporting laws.

The Federal Government investigation has effectively terminated my business.

This completes my statement.

Senator Rudman. Thank you, very much.

We will recess for about 10 minutes while we complete a vote. Then we will come back with some questions.

[Member present at the time of recess: Senator Rudman.]

[Member present after the taking of a brief recess: Senator Rudman.]

Senator Rudman [presiding]. The subcommittee will come to order.

We have what appears to be possibly a series of votes on the floor of the Senate. I think we will try to conclude your testimony, Mr. Ghitis, and then as far as the other witnesses are concerned, we will just have to see whether or not we are going to recess for an hour or continue.

Mr. Ghitis, you have stated that during 1 month in 1982, you handled $50 million and that the major portion of this money came from one side. Yet, you state that you checked the background of this individual and found nothing wrong.

How do you explain this enormous amount of money coming to you in the United States from an individual who I understand resides in Colombia?

How do you account for information the subcommittee has received from law enforcement people identifying your client as a major narcotics supplier in Colombia?

Mr. GHITIS. Senator, in 1981——

Senator RUDMAN. Could you move the microphones a bit closer so I can hear you?

Mr. GHITIS. Yes.

Senator RUDMAN. Thank you.

Mr. GHITIS. The date quoted should be 1981, 1982, I am not sure. That person is known in Colombia to me as a money changer. His reputation is known to banks. I have checked his reputation and although in the case where part of this money was seized, the court found that they were performing functions of the money change office.

Nothing else.

Senator RUDMAN. As obviously a very experienced businessman, did it not occur to you at some point with these enormous amounts of money that this might not all be from coffee and other commodities?

Mr. GHITIS. Yes and no. We had many clients which we refused to do business with because we were suspicious or more than suspicious that they were trading in dollars generated from drugs.

In fact, as we were the largest, one of the largest exchange offices in Colombia, we were approached very often by individuals in the drug business who wanted us to launder their money.

Normally, such an interview would not only request change dollars for pesos, but he would request to change dollars for dollars which means that we would deliver dollars as cash into the United States and request us to send a wire transfer to a secret jurisdiction or to give him an exchange cashier checks.

We always refused to do that kind of business. We refused every time to do business with a person who we didn't or weren't convinced that he was good.

With respect to the big amounts, if I may, do that question with three answers.

The first one is, how much really matters how much I suspected from an individual when he was, I mean not for money, from an individual, but from the overall source of the dollars if they were generated from drugs.

Let me give you an example. The bank we were working with in Miami, Capital Bank, was receiving from us on a daily basis in those months you quoted around $1 million, $2 million a day. Those moneys in cash were delivered to the Federal Reserve System.

The Federal Reserve System 1 year previous to that was receiving from that branch, if at all, no more than $100,000 from that bank daily.

Senator RUDMAN. That is from all sources?

Mr. GHITIS. Yes.

Senator RUDMAN. You are saying that gently it was $1 or $2 million a day?

Mr. GHITIS. Excuse me? No. What I am saying is that the Federal Reserve System in Miami started to receive big amounts of cash from Capital Bank. The Federal Reserve System tried to from Capital Bank or to their knowledge they had or should have known that that money had to be drug generated because we are talking about Miami; we are talking about huge amounts of cash; we are talking about a branch that 1 year previous to that were not sending even one-tenth of the amounts daily. And they didn't do nothing. They didn't have to do nothing because they knew that the Capital Bank was no drug business, Capital Bank was receiving that money as part of their functions as a bank.

The same thing applies to me. I was receiving the vast majority of the money that I was purchasing from money exchangers which I knew that were not involved in drug business.

I knew that they were purchasing those dollars; they were giving pesos for those dollars.

As I told you, everytime we suspected somebody that he was in the drug business, we refused to do business with him.

Senator RUDMAN. Of course you really had no way of suspecting if, in fact, you were dealing with intermediaries. So if A, B, C, D, E, F and G are all drug dealers, they go to money exchanger "2" who comes to you and you know "2" is a money exchanger. So you just do business with him.

Mr. GHITIS. Yes; we requested many applications through those who were money changers. We requested to know what were the sources. We were delivered general anwsers of the kind that I can give to you that the sources were conventional sources, that they also didn't do dealings with drug people.

When we tried to ascertain the identities of those clients in order to be sure that they were functioning as we expected them to be functioning. They denied that information to us because we were in the United States in a position to compete with them.

Senator RUDMAN. As a matter of fact, in June of 1981, you met with the president of your bank and he discussed his concern about the source of this enormous amount of money. I believe that if the records are correct, based on your prior testimony, you told him you suspected it was possible that a substantial amount of this money might well have been generated from drug transactions.

Mr. GHITIS. Not so exactly.

Senator RUDMAN. That is not correct?

Mr. GHITIS. It is not correct. The testimony of Mr. Holtz as well as mine shows that a conversation that we had, Mr. Holtz and I concerned my desire to see Government agencies in order to show my books and see if I was complying with the law and, if not, what I had to do.

We discussed the source of the dollars and I told Mr. Holtz that I never did any kind of dealings with any person who I suspect was in the drug business. As a matter of fact, all my clients I knew that were in business other than the drug businesses and the major portion of the moneys that I was receiving, I was purchasing from other money exchangers.

What I told him is the question of, to me, if I do guarantee that all of his clients were so pure. I told him I could not guarantee that.

Senator RUDMAN. Essentially what you are telling this subcommittee is that, since you did not deal with the eventual beneficiary of exchange, but an intermediary, a smaller money exchanger, you really were insulated from any knowledge as to where the money was really coming from?

Mr. GHITIS. It is a little different between what you are saying and what actually was my way of thinking. If I had known that exchanger didn't have any scruples against purchasing dollars from drug people, even though I was isolated by secondhand transactions, I would not have been doing business with him.

Senator RUDMAN. Mr. Ghitis, let me put it this way:

Coffee is a very major export of Colombia?

Mr. GHITIS. Yes.

Senator RUDMAN. Am I correct or incorrect in saying that the major coffee exchange transactions are done on letters of credit between major banks in Colombia, major banks in the United States, usually on delivery receipts and that those moneys generally are subject to wire transfers like most other major commercial transactions?

Mr. GHITIS. You are correct in part, sir. The Colombian exporter exports everything that he declares in such a way that his payment should be received through the Banco de Republica, which means that every dollar paid to him should be wire transfers to a bank in Colombia which in time should deliver that to the Banco de Republica for adequate exchange to peso.

The amounts that you are now quoting are the 50 percent of Colombian Government estimates that is traded and underground which could not be traded, those dollars coming from conventional products, cannot be exchanged at the Banco de Republica. They cannot be wire transferred to banks in Colombia because every wire transfer made to a bank in Colombia has to be delivered to the Banco de Republica.

There are no dollars, accounts in dollars in Colombia. So if an importer, American importer sends $500,000 to a Colombian exporter to Colombia, the bank cannot do anything with that in Colombia except send it to the Banco de Republica for exchange.

So those figures for the declared exportations should be and are traded and exchanged by the Banco de Republica. Those quantities which are not declared cannot be traded through the Banco de Republica and they have to apply to the black market which is the money exchangers.

There is where we are and if we know that the overall exportations of Colombia, for example, in 1980 or 1981 were around $3 billion, we are talking about an additional $2 to $3 billion which have to be traded through money exchangers.

Senator RUDMAN. I just want to follow that line of questioning a little bit more.

Let's just limit it to coffee.

Mr. GHITIS. Yes.

Senator RUDMAN. Am I right in saying whether they value it correctly or incorrectly, the major portion of coffee exported by Colombia to American importers is paid for by a wire transfer from American banks to the bank in Colombia?

Mr. GHITIS. I don't think so. I would say only 50 percent of it which is what the Colombian statistics show is paid through the Banco de Republica.

Senator RUDMAN. Let me interrupt for a moment.

That would require a conspiracy on the part of the American importer as well.

Let me give you a hypothetical situation:

You are a Colombian exporter of coffee and I am an American importer—Maxwell House, let's say, or one of their various brokers—and I buy $10 million worth of coffee, but you really only list on your export declaration $5 million. Are you telling me that the American importer is going to wire $5 million to the Colombian exporter and deliver $5 million in a brown paper bag to somebody who comes to the door and says I am here for my other $5 million?

Mr, GHITIS. No, sir.

Senator RUDMAN. Then you tell me how it works. Because I think I know how it works.

Mr. GHITIS. That was exactly what I was going to do.

The Colombian exporter, let's say, the ones who export $1 million worth of coffee, what he does is he ships in one shipment $1 million worth of coffee, the same shipment. According to the Colombian customs, only $500,000 worth of coffee are being shipped. When they arrive to the United States, they do not arrive to the United States as $500,000 but as $1 million. The American importer is importing $1 million in coffee.

Senator RUDMAN. Now he has to pay for it?

Mr. GHITIS. He has to pay for it.

Senator RUDMAN. Tell us how he pays for it.

Mr. GHITIS. The only thing he does is he separates the payments in to two, one is $500,000, which he pays according to the Colombian exporter to a commercial bank and the other $500,000 he pays to the Colombian exporter to the other bank.

Now, the Colombian exporter——

Senator RUDMAN. Let me interrupt. In other words, that is under the instructions of the Colombian exporter who tells the buyer in America that he wants his payment in two sections, half to be wire transferred and the other half to be sent to a bank in Miami or Atlanta, whatever?

Mr. GHITIS. That is it.

Senator RUDMAN. I think we ought to have a hearing and invite all the coffee importers in.

Mr. GHITIS. That is only one, of course, of the methods.

Senator RUDMAN. So it was your belief at the time that a lot of the money you were handling was concealed over declaration exports by Colombians and you were exchanging money for that other half or 30 percent or whatever for the legitimate products?

That is what you testified to and that is what you believe?

Mr. GHITIS. The Americans statistics show values for the importation from Colombia which are 35 percent higher than the Colombian figures for exportations to Colombia—that is not something that I believe. That is something that is real.

Senator RUDMAN. I have no reason to doubt that is true. I am just trying to understand. I am not saying that you are not testifying truthfully. I am just trying to find out whether you know who is gouging whom around here. There are a lot of other things we can do in this subcommittee.

You appeared before this subcommittee voluntarily. You have been given no immunity. I understand your criminal case and your civil case are both under appeal.

Mr. GHITIS. Yes, sir.

Senator RUDMAN. If my understanding is correct, you are calling attention to yourself by going to the Internal Revenue Service and asking if you were conforming with all of the laws.

Is that an accurate statement?

Mr. GHITIS. Yes. In March 1981, the IRS was investigating Capital Bank.

Can I continue?

Senator RUDMAN. Yes. Go ahead.

Mr. GHITIS. We were advised that IRS wanted through Capital Bank to see our registration and license for the money exchange in Colombia. We sent out and I came to the United States and I advised the chairman of the board of Capital Bank that I wanted to meet with those agents.

It was in more than one occasion that I did that. Mr. Holtz, chairman of Capital Bank, advised the IRS special agent, Jerry Christiansen, that we wanted to meet with him to open our books and seek advice as to whether we were complying with the laws of the United States and if not, what we should do.

Senator RUDMAN. Did you do this on advice of counsel at the time?

Mr. GHITIS. Yes, sir, we had prior to that, 1 month prior to that, sought advice from counsel. That counsel had told us that we were not functioning in the United States as a domestic institution but in Colombia we only had to keep records of those dollars exchanged in our office but we didn't have to file the currency transaction reports.

Senator RUDMAN. Until you went to the Internal Revenue Service through your bank and asked them for advice, no agency of the U.S. Government had ever come to you and asked to look at any of your records; is that correct?

Mr. GHITIS. No. I understand it was dollars by Mr. Moore, I believe is his name, who was vice president in the Bank of Miami, where we used to have their account, that there was once an investigation of an agency, I don't know which agency, and the bank, our account was investigated also and they advised the bank that our account was OK.

Senator RUDMAN. I am going to have to suspend again for another vote over on the floor of the Senate.

I will probably come directly back. I would like you to remain.

I have a few other questions I would like to ask you. The subcommittee will stand in recess for, hopefully, not more than 10 or 15 minutes.

[Brief recess.]

[Member of the subcommittee present at the time of recess: Senator Rudman.]

[Member present after the taking of a brief recess: Senator Chiles.]

Senator CHILES [presiding]. We will reconvene the hearing.

Mr. Ghitis, as you know, the subject of these hearings relates to the effects on the United States created by the offshore banking industry. You were an offshore financial company from the U.S. perspective. You moved millions of U.S. dollars through your account in Miami, I assume at great profit to yourself personally or to your company.

Would you tell the subcommittee, did you, your consortium, or your company, ever pay any U.S. taxes on any of these transactions?

Mr. GHITIS. No, sir; one of the items that we wrote up and which led us to seek advice from our attorney in the United States was if we were liable, tax liable, and if yes, what kind of tax return we had to file.

We were advised and that was in accordance with what we thought, that because all these transactions were done in Colombia and the only thing that was done in the United States was the delivery of dollars into the account, that we are not taxable in the United States.

An example that was quoted was of an importer of cars in France, let's say, who buys 100 cars from General Motors and stores them in a warehouse. He, then, goes back to France and sells those cars to other people. He gives the receipts and everything. The people either can come to the warehouse in the United States and pick up the cars or have them sent to France or wherever they want and our situation was more or less like that.

That person in France was not tax liable in the United States. We are not.

Senator CHILES. Were you not making money off both ends of the transaction? You were making money off the buying end and the selling end? It is a little bit different.

Were you not?

Mr. GHITIS. No, sir. No, sir. It is very difficult for an American person to understand how you trade dollars.

If you regard the dollar as just a commodity, then you, in my business, you only have two steps.

One of them is the investment of pesos into dollars which is the investment of pesos to buy merchandise. Once you have the merchandise, you sell the merchandise and you receive the pesos back and your profits.

Only when you come to the full cycle you have your profits. The purchase was done in Colombia, however the delivery was done in the United States. The sale, however, which is what defines taxable event, was done in Colombia. We never did anything the sort of selling in the United States; is that clear?

Senator CHILES. I see what you are saying.

Has the Internal Revenue Service in this country raised or placed any tax lien upon you or sought any payment of taxes?

Mr. GHITIS. Yes, sir. I was assessed a tax lien of $11 million by IRS.

Senator CHILES. What is the disposition of that?

Has there been a disposition?

Mr. GHITIS. No. I understand that it is still pending in court. We are fighting it. I am not in fact aware of what is going on.

Senator CHILES. In addition to your sentence, I understand that a fine was levied against you?

Mr. GHITIS. Yes.

Senator CHILES. $60,000; is that correct?

Mr. GHITIS. A fine?

Senator CHILES. $610,000?

Mr. GHITIS. Sentencing?

Senator CHILES. Yes.

Mr. GHITIS. Yes, sir.

Senator CHILES. Have you paid that fine?

Mr. GHITIS. I don't have money to pay my attorneys. How can I pay the fine? This is my money.

There is one thing that you should know.

When our accounts were seized, a total of about $10 million were seized from those accounts. From those $10 million, $2 million were working capital. The rest was representative of funds of checks in dollars that we had already sold in Colombia to clients.

In fact, the claimants for that $10 million were hundreds and thousands of persons holding Sonal checks in Colombia. I was required, in order to cover part of those debts, to sell all of my property in Colombia, and at this moment, I am still owing in Colombia about $4 million or $5 million.

I don't have any property. And I am still responsible for the rest of the $10 million to checkholders who have not been paid yet.

Senator CHILES. So your statement is that you have sold your assets. Your assets in Colombia have been sold to pav off claims that you have?

Mr. GHITIS. Yes, part of the payments.

Senator CHILES. So you have not paid the U.S. Government the fine?

Mr. GHITIS. I considered the first priority was to pay those that I owed and anyway, I wouldn't have any money left to pay the Government if I had to.

Senator CHILES. Is the family business still operating in Colombia?

Mr. GHITIS. No; it was terminated. It is in Colombia, it is still doing some kind of transactions, local transactions, but if you compared it to the volume, we are not doing more than half percent of what we used to.

Senator CHILES. Where are the people that formerly were doing business with you? Where are they are transacting their exchange business now?

Mr. GHITIS. Are you talking about the persons that used to purchase the checks?

Senator CHILES. Yes, I understand a large part of your business was coming from several very large clients.

Mr. GHITIS. Yes.

Senator CHILES. Where are they changing their money now?

Mr. GHITIS. I don't know. I really don't know. I can guess that they went back to what was usual before I went into the market, which was receipt of payment in the form of checks, for example, the same coffee exporter we were talking about and he received $500,000 which he was not able to exchange at the Banco de Republica because he did not declare those exportations.

Instead of cashing the check that he received from the importer in the United States, he is now probably receiving a check in dollars which he goes to Colombia, waits 30, 40 days, until it gets exchanged by local exchangers in Colombia.

Senator CHILES. Local exchangers in Colombia, by breaking it down through a number of smaller local exchanges or just having to wait?

Mr. GHITIS. They have to wait. We took over that market because we offered the depositing of cash in the United States and paying immediately the pesos over in Columbia where before that people who had received payment, either in the form of checks or dollars in accounts had to wait many days until their checks got here.

Senator CHILES. I was just trying to check on the vote.

There were two other operations that were doing business with you, two other exchanges?

Mr. GHITIS. There were several.

Senator CHILES. They were not as well known.

What happened to those two exchanges?

Mr. GHITIS. I don't know. I didn't have time to bother to see what happened. I was full of problems myself.

Senator CHILES. They were not charged at the same time you were charged?

Mr. GHITIS. I understand that one of them, their office was seized 2 or 3 months later by IRS. The other one, I don't know what happened.

Senator CHILES. You don't know whether they are still in operation?

Mr. GHITIS. No. Immediately thereafter, I went out of the market. I didn't have any connections. I was trying to get something done and was working closely with my attorney.

Senator CHILES. Do I understand your case is still on appeal?

Mr. GHITIS. Yes; we appealed the civil case and we, of course, appealed the criminal case. I am sure that they will be won. I don't know if it will be appealed to the Supreme Court.

Senator CHILES. Are you incarcerated now?

Mr. GHITIS. Yes. I am serving; in custody.

There is one question that was asked by the Senator which I didn't understand, concerning the Government approaching me prior to that location. He viewed the large quantities that we were dealing in.

One thing that we have been complaining at the time is the Government never tried to approach us to tell us you have to do so and so, what are you doing?

The only time that we tried to approach them they hide from us.

Senator CHILES. They what?

Mr. GHITIS. They hide from us.

Senator CHILES. They hide from you?

Mr. GHITIS. Yes.

Senator CHILES. Was this before or after they had seized?

Mr. GHITIS. It was before. Before the seizure, as I explained, Agent Christiansen, special agents from the IRS received our message that we wanted to meet with the IRS. And sent a message with Capital Bank, chairman of the board, that he would get to us when he is ready to get to us.

The chairman of Capital Bank told us, don't worry, everything is okay. You can go on working.

Senator CHILES. How long was this before your arrest?

Mr. GHITIS. It was at the same time that I allegedly by the Government committed the violations for which I was convicted and it was 6 months prior to the seizure.

Senator CHILES. Six months prior to the seizure?

Mr. GHITIS. Right. The seizure of the money. I was, that situation that I am telling you about with respect to the agents, occurred in March of 1981.

Senator CHILES. How did you contact them?

Mr. GHITIS. Through Abel Holtz, chairman of Capital Bank. I was telling you, that event occurred in March of 1981. The seizure of the accounts occurred in August of 1981 and I was arrested when working out of the courthouse in the civil case in September of 1982.

Senator CHILES. In September of 1982?

Mr. GHITIS. Yes.

Senator CHILES. That was almost a year after the seizure?

Mr. GHITIS. Well, the Government had to take my records and understand them before they were used against me. And examine them.

Senator CHILES. How did you—the statement seems to be that you had a conversation with Mr. Eisenstein, that you had a conversation that you knew he had been talking with Customs.

How did you know that? What information did you have?

Mr. GHITIS. No, sir, that is one of the things that the Government tried to hide in the civil case. In fact, in August of 1981, we were approached by the Government, who had requested, asked to cooperate with them in mounting laundry operation for the Government, that they had with banks, with video cameras, and so forth. We rejected that but in principle, we were willing to talk with the Government.

My agent in the United States talked with the Government and agreed to cooperate with them. The Government asked us to start filing, furnishing reports which we were not filing because we didn't know we had to file.

Five days after that, the Government talked my agent into making a conversation to me in order to illustrate some incriminating statements from me. The Government wanted to know exactly if I was sending cash from Colombia to the United States. So my agent made a conversation, Special Agent Fernandez from Customs was listening on the extension in the office in Miami.

My agent asked me if I knew where the money was coming from because there was not one form to be found when we received currency, but two forms, one for currencies that are domestic which is the situation, I knew the latter, and the other one when the currency is coming from out of the United States, which is the customs form.

I told my agent that I didn't know, that I believed that the money was from the United States, that I didn't know also that there were two kinds of reports, that I regretted and that we didn't ask our client that and from then on, we started asking our client not only if you identify, but also where the money was coming from if it was not coming from the United States.

In that same conversation, my agent, he asked me what about the other things that the Government had requested from us which was to monitor the cameras and agents in the office.

I told him that would have to wait until I came to the United States. I was scheduled to come to the United States on the same day that the money was seized but the Government talked me into coming 1 week later so they wouldn't have time to seize the accounts.

So I was scheduled to come 1 week from then on. I told my agent that that had to wait. I remember that one of the exchangers, from which we were purchasing dollars, had told me that the rules that we had, one of them was that nobody would be delivering money in the presence of any one more than my agent. My agent had told me that he has his agent deliver money to my office and there were one or two other persons present.

I requested my agent to tell me who was that person and why he was breaching the security rules and he had begun to behave very nervous over the phone.

He couldn't tell me that in fact what happened is customs had seized the office and were in the office. So I understood that from his behavior. I told him to close the office, go away, look for an attorney, and put all the money in the safe deposit boxes so that the money would not remain in the office.

Senator CHILES. The bank raised its rate to you several times.

Why was that?

Mr. GHITIS. At the beginning, it was claimed by the bank that they had very high costs due to money costs of the bank for the service, wherever they were sending the cash.

The policies, the insurance policies, had been increased because they were holding too much money in the bank. They had to pay extra tellers and so forth. That was the main reason why they raised it to 0.5 percent which was one before the latest rate that we were paying to the bank.

Senator RUDMAN. I don't understand his answer.

Are you telling the subcommittee that a bank raised your rates because you were putting too much money in the bank?

Mr. GHITIS. Yes.

Senator RUDMAN. This is the first time I have heard that.

Mr. GHITIS. All the banks in Florida are doing that.

Senator CHILES. This was the time before the big raise, though.

Mr. GHITIS. No; there was never a big raise. As a matter of fact, we were——

Senator CHILES. Originally, you were paying a service fee of one-eighth of 1 percent?

Mr. GHITIS. That is right. We were paying, not one-eighth, we were paying 0.15, which one-eighth is 0.125. The banks in Miami were paying, were requesting for cash deposits around 0.25 percent. That was normal procedure in Miami.

The amount, the rate was raised from 0.15 to 0.20 and thereafter, immediately, to 0.30, which didn't make much difference then because that was more or less the rates most of the banks were charging.

Three months after that, the bank complained that that was not enough for paying the insurance, extra costs, extra guards, extra payment of clerks and so forth and they wanted to collect 0.5 percent.

We agreed to pay 0.5 percent. It was in late 1980. I believe, mostly because most of the banks in Miami were charging around 0.5 percent by that time. That is one reason.

The other reason is because of the moving of an account like Sonal which has so large floating balance and thousands of checks floating all over the world from banks, one bank to another bank, is a very complex matter.

You have to be—well, if you can avoid transferring that account from one bank to another bank, you should do it. So we stayed at the bank paying 0.5 percent in 1981, at the volumes that we were depositing, for example, in 1 month in 1981, we deposited around some $40 million in 1 month.

We were paying $200,000 that month for those deposits. You got to undertand that although that is an incredible amount, our profits averaged difference between the selling, buying price was around 2 percent.

So we were giving away 0.5 percent which is 25 percent of our gross profits to the bank.

In June 1981, I believe that due to the fact that the bank knew that the Government was going to seize our account because of what the IRS had told the bank, the bank decided either to take a picture or give us away, close the account and they raised the fee to a fixed $300,000 a month, which, well, as big a city as it is, raised only from .5 to .66 percent.

Senator CHILES. So you were going——

Mr. GHITIS. No, we needed research for other banks immediately. We were in at least three other banks. We showed in civil case letters that we had sent to other banks where we wanted to transfer our accounts.

We even in those letters to the banks told the banks that before they opened our accounts, they should check with the Federal authorities which probably know who we are, so as to be sure that they are not opening just a laundering account but an account of dealing only with conventional exchange.

Senator CHILES. Did the bank say anything to you when they were raising that fee to $500,000 per month, why they were doing that? They already got the extra money.

Mr. GHITIS. No. I was met with an attitude that I didn't understand. In fact, I couldn't speak with the chairman of the board. I wanted to complain. I was handed a document by the vice president of the bank in which they had already agreed to my agreement to that rate and explained to me that either I sign that document or they would close the account on the spot.

Of course, I couldn't close the account on the spot which is what I wanted to do because I couldn't afford to let my business collapse, which is what would have happened if all the checks started to be returned.

So what I did was played with the bank, for a time it took me to find other banks and in that process, in the middle of that process, my accounts were seized by the Government.

Senator CHILES. Did the bank ever say anything to you about being concerned about their exposure because this money, the large sums that you had, could only have been generated by drug transactions?

Mr. GHITIS. No, no; I believe that is a statement that Mr. Harlan DePose gave in an affidavit that was imposed upon him by the Government and he has declared as to that. But such a thing was never told to me.

Senator Rudman. Thank you, Senator Chiles.

It is rather interesting, I think, that in certain banks you pay $200,000 a month for the privilege of depositing money there. That is a very unique circumstance.

Can you tell me, did you mention at this hearing that you have a 2-percent spread as your operating margin?

Mr. Ghitis. Excuse me.

Senator Rudman. 2 percent was your profit margin?

Mr. Ghitis. More or less.

Senator Rudman. So on a $50 million month you would be making $1 million gross profit?

Mr. Ghitis. In $50 million—yes.

Senator Rudman. On a $30 million month, $600,000?

Mr. Ghitis. Yes.

Senator Rudman. Your expenses were, of course, your bank charge which varied but let us say it was about $200,000 to $300,000, depending.

Mr. Ghitis. There are some other risks.

Senator Rudman. I didn't say those were all the expenses. That was an expense.

Mr. Ghitis. My expenses, my fixed expenses were very little.

Senator Rudman. What was the actual net profit from this operation in the month that you did? For every $10 million you exchanged, what was the net profit per month?

Mr. Ghitis. It is impossible to quote. I would say that a good month would be, a net profit of $200,000.

Senator Rudman. $200,000 net profit on a good month?

Mr. Ghitis. Yes.

Senator Rudman. What kind of volume would that require?

What would a good month be?

Mr. Ghitis. $40 million.

Senator Rudman. So this was a several million-dollar a year operation in terms of profit?

Mr. Ghitis. It should be; yes.

Senator Rudman. Do you recall any transactions in which you maintained accounts by wire transfer or otherwise with banks in the Caymans, or Panama, Hong Kong, any other foreign off-shore bank?

Mr. Ghitis. Yes, sir. We, as I am telling you, always refused to exchange dollars receiving cash for such transactions. As a matter of fact, our clients on the purchasing end were always different from our clients on the selling end. The only wire transfers that we did to Panama, laundering in some occasions, Taiwan, were always wire transfers requested by companies, companies, some of them multinational, some of them Colombian companies, very well known for the purpose of importation of goods, never to what is called secret jurisdictions, like Switzerland, Cayman Islands, or Aruba, and so forth.

Senator Rudman. You did not maintain your own accounts in those banks?

Mr. Ghitis. No, sir.

Senator Rudman. You did not deposit by wire exchange amounts on behalf of the private customers?

Mr. GHITIS. No, sir.

Senator RUDMAN. Thank you, very much, for appearing here voluntarily. You have added a great deal to the record.

Mr. GHITIS. Thank you, very much, sir.

Senator RUDMAN. The next witness will be Mr. Thomas Stocks.

If you would raise your right hand, do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. STOCKS. I do.

Senator RUDMAN. Would you please be seated and state your name for the record.

We have your statement.

You can summarize it in any way, although it is a short statement.

We are running short of time.

If you cannot summarize it, you may deliver it completely.

Mr. STOCKS. Thank you. Perhaps it would be best if I would just read it, but go through it quickly.

Senator RUDMAN. Thank you.

TESTIMONY OF TOM D. STOCKS, FORMER PRESIDENT, OXFORD INTERNATIONAL BANK AND TRUST COMPANY, LTD., TURKS AND CAICOS ISLAND

Mr. STOCKS. My name is Tom Stocks. I reside in Miami Beach, Fla., and am presently the manager of an air cargo company in Miami. For the better part of the last 25 years I have held management positions at various large banks in the Midwest.

I hold a degree in finance from the University of Wisconsin, and have completed additional programs at Rutgers University and Harvard University. From 1975 to 1979, I was the president of the Oxford International Bank and Trust Co., Turks and Caicos Islands, British West Indies.

The Oxford Bank was founded and owned by Mr. Normal Michael of Boynton Beach, Fla. I met Mr. Michael through a mutual acquaintance in the Turks and Caicos Islands. In 1968 and 1969, I bought property in the islands and had visited there many times prior to 1975.

When Mr. Michael approached me with the offer of being president of the Oxford Bank, he stated that he expected to have at least $3 million in capitalization by the end of the first year of operation.

The Oxford Bank was formed with $250,000 in capital and the additional capitalization was never provided by Mr. Michael. This forced me to operate from a position of undercapitalization and contributed to the eventual failure of the bank.

When the Oxford Bank was formed, we were one of only two full-service banks in the islands, the other being the Barclays Bank. We operated three offices in the islands, the main office in Grand Turk and branches in North Caicos and Providencialas.

At this time in history, there was distrust for the new independent government in the Bahamas. This caused literally billions of dollars to leave the Bahamas and created a large new market for Caribbean banking.

The Turks and Caicos Islands were a British Colony with no taxes of any kind and virtually no laws regulating the banking industry, in fact, very similar to the Cayman Islands. There was no central banking authority and little mechanism for auditing the operation of the banks.

We were only required to file a formal financial statement annually to the government. Any new merchant bank had to be approved by the Bank of England. Beneficial owners were required to be approved by the local government. However, this could be easily circumvented through the use of nominee owners.

At its peak, the Oxford Bank had approximately 1,000 savings accounts, very few being held by U.S. citizens, and between 500 and 600 checking accounts, over half of which were U.S. customers.

At that time, the Turks and Caicos Islands were developing a reputation as an emergency tax haven and this fact brought a great many U.S. customers to the islands. Many corporate customers, of the Oxford Bank were referred to us by Turks and Caicos attorneys.

I would estimate that as many as 1,000 "shell companies" were established in the islands during this time period. These companies may not have been used as business operations but their creation provided business for the banks.

More recently, approximately 1,000 companies were formed in the past year bringing the total to 3,500 to 4,000 companies on the company registry.

For the most part, these new companies are exempt nonreporting companies.

It is my understanding that there is a favorable attitude toward the creation of so-called brass-plate banks in the islands.

Additionally, several U.S. customers were referred to the bank by a U.S. citizen named Lowell Anderson. During my June 1982 interview with staff members of this subcommittee, I identified many of the accounts opened as a result of Mr. Anderson's efforts.

Mr. Anderson had no official relationship with the bank, he simply referred customers, most of whom established accounts at the bank in the names of trusts. It is my understanding that Mr. Anderson set up trusts for these people through local island residents, such as cab drivers, who sold their services in the grantor trust business.

During this same meeting, I was asked to comment on why a U.S. citizen would open a bank account at a bank such as the Oxford Bank. In my opinion, the only legitimate reasons for such action are to participate in the Eurodollar market or to finance an offshore operation.

I saw little evidence of either of these in the majority of the U.S. accounts at the Oxford Bank. However, as I did not observe an inordinate amount of questionable transactions among the U.S. account holders, I saw no reason to infringe upon the privacy of our customers by monitoring new or existing accounts.

I do believe that the reason the majority of the U.S. account holders opened accounts at the Oxford Bank was for the purpose of tax avoidance or evasion. Since money earned offshore is not taxable until returned to the United States, inflation creates a profit factor by simply leaving moneys offshore for a period of time.

The Oxford Bank unwittingly became involved in two questionable business deals, the latter of which ultimately resulted in the failure of the bank. The first incident involved a man named George Edder and a $5.5 million certificate of withdrawal.

The certificate was purported to the bank to represent 10 million pounds of copper and was delivered to the Oxford Bank for safekeeping. Mr. Edder appeared at the bank one day claiming ownership and demanding return of the certificate. Since the certificate was delivered to the bank by someone other than Mr. Edder, his request was refused. He protested strongly to officials of the Turks and Caicos Government and damaged the reputation of the bank. Mr. Edder proceeded to file a $5.5 million lawsuit against the bank in California. The suit was eventually settled out of court but not without substantial expense to the bank, both monetarily and in reputation.

The second incident involved a man named Fred Yeager who had applied to the Turks and Caicos Government for three bank licenses. Mr. Yeager opened an account at the Oxford Bank and in his dealings with me indicated that he represented certain individuals in Madrid, Spain, who had securities they wished to sell.

Yeager requested that the Oxford Bank act as intermediary in the sale of the securities so as to keep the funds offshore and insulate his Madrid clients from taxation. After some negotiation, I opened an agent account in the name of the Oxford Bank at Merrill Lynch in New York City to facilitate the sale of the securities.

In November 1978, Yeager telephoned me and requested that I meet him in New York. I was unable to go to New York, but I did agree to meet Mr. Yeager in Haiti. At that meeting, he gave me $75,000 worth of New York City Battery Park bonds. I examined the bonds and observed nothing out of the ordinary and therefore I agreed to act as intermediary in their sale. Shortly thereafter, I sold the bonds to Merrill Lynch in New York for delivery against payment in Florida.

I returned with the currency to the Oxford Bank and subsequently distributed the proceeds to Mr. Yeager and various other parties in the Caribbean.

Senator RUDMAN. Can I interrupt you there? I want you to go over that particular transaction at this point in your statement.

If I understand it correctly, the bonds were delivered to Merrill Lynch and payment was made to a bank in Florida?

Mr. STOCKS. Yes, that is correct.

Senator RUDMAN. In the amount of $750,000?

Mr. STOCKS. It was, that was the face amount. It was, I think, $565,000, something like that.

Senator RUDMAN. You then took that in cash and got on an airplane, taking it back to your bank?

Mr. STOCKS. Yes.

Senator RUDMAN. OK.

Mr. STOCKS. Approximately 2 weeks later, I received $500,000 worth of bonds and subsequently deliveries of $700,000 and $2 million worth of bonds to negotiate for Mr. Yeager and his representatives.

In each instance, I sold the bonds to Merrill Lynch in New York and delivered them to their office in Miami against payment. Following the sale of the $500,000 and $700,000 in bonds, I took the checks received from Merrill Lynch and went to Oxford's correspondent bank, the Southeast Bank in Miami. I negotiated the checks and took the currency to the Turks and Caicos and distributed it as before. Since these were transactions between two banks, the Oxford and the Southeast, I was not required to report the currency transaction under then existing U.S. laws.

The $2 million transaction was never completed. When I arrived at Merrill Lynch in Miami, I was met by agents of the FBI. It had been discovered that all the bonds in these transactions were previously stolen. In fact, the first set of Battery Park bonds were stolen from Merrill Lynch, although they did not discover the theft until a month after they purchased them back from Oxford Bank acting as agent for Yeager's clients. As I was totally unaware and uninvolved in the criminal aspects of this affair, neither I nor the Oxford Bank was charged with any crime.

Following this incident, Merrill Lynch obtained a court order freezing Oxford's bank account at the Southeast Bank in Miami. Ultimately this caused the bank to have liquidy problems in its daily banking transactions and caused the Turks and Caicos government to revoke the bank's license in April 1979.

Fifteen months later, I returned permanently to the United States and found on a subsequent visit to the islands that I was persona non grata.

In these cases, the Oxford Bank was unwittingly used by the criminal element. However, these incidents exemplify the type of criminal schemes which can be perpetrated against or through an offshore financial institution.

During my employment at the Oxford Bank, I am aware of one instance when an island bank accepted a deposit of $575,000 in cash in a suitcase. On another occasion, I was approached by an island attorney who represented a client desiring the Oxford Bank to handle $11 to $12 million in cash.

I believe that was the same customer that had the $575,000. Prior to a decision from the Oxford Bank, I understand the client completed his transaction through a bank in Panama.

From experiences such as these, I am of the opinion that what is needed is a banking information clearinghouse to provide information on banks and banking in the area. I feel this would be more substantial in resolving banking problems in that area of the world than any central banking organizations that might be established.

That concludes my prepared statement, Mr. Chairman.

I would be happy to answer any questions you may have.

Senator Rudman. When you were carrying $500,000, $600,000, $700,000 between Miami and your bank, did it ever occur to you that this money was being taken offshore for reasons other than legitimate reasons?

Mr. Stocks. Well, no, not for reasons other than legitimate reasons. Again, defining a legitimate reason as the avoidance or postponement of tax payment.

Senator Rudman. Why would anyone want to put that kind of cash in your bank when they could have left it in your account at the corresponding bank in Miami?

Mr. Stocks. None of that cash remained at the Oxford Bank. It was all paid out immediately. The only money that was in the account at the Oxford Bank was whatever profit the bank made on the transaction.

Senator Rudman. Let me understand the transaction. You arrived back at your island bank and you put that money in your vault where it was then credited to the account of the person for whom you made the transaction, with Merrill Lynch?

Is that correct?

Mr. STOCKS. Yes.

Senator RUDMAN. What happened then?

Mr. STOCKS. Subsequently we would simply have a check that would be written out, withdrawing the bulk of that money and that money would then be delivered to individuals offshore.

In other words, in one case, I went to the bank and I, then, went to St. Martin and delivered the money in St. Martin.

Senator RUDMAN. You delivered the cash?

Mr. STOCKS. Yes.

Senator RUDMAN. Didn't it bother you traveling around the Caribbean with one-half of a million dollars in a suitcase?

Mr. STOCKS. Now that I have had more time to reflect on it, I guess it was a little bit ridiculous at the time.

Senator RUDMAN. It sounds like it to me.

My understanding is that the reason there was no reporting of these large currency transactions going out of the country was because they were transactions between banks.

Mr. STOCKS. Yes; as I understand it now there should have been reports filed because it was being handcarried. If it was going on a common-carrier vessel, there are no transaction reports such as that. But when we tried to do it common carriagewise on the airplanes going back and forth between the islands and Miami at that time, it was just such a hassle, they didn't really want to help accommodate it.

You know, it meant additional insurance, all of that for them.

Senator RUDMAN. What would you charge for that kind of transaction?

What was the bank's charge?

Mr. STOCKS. I think that was 1 percent, something like 1 percent.

Senator RUDMAN. Plus your expenses?

Mr. STOCKS. Yes, plus expenses.

Senator RUDMAN. That is a fairly substantial amount of money, isn't it, for a trip to Miami or New York and back?

Mr. STOCKS. Yes; I never went to New York on those transactions, but it is a substantial amount. I think, unfortunately, for this committee and the people looking at things such as this, this is one of the reasons why this type of activity occurs in the small bank because relative to the size of the bank, the income earned was substantial. In fact, the only time the bank made any money in any one month during the time the bank was open was during the time that it had these security transactions.

I mean it didn't make a lot of money, but it made a few thousand dollars, $30,000, something like that profit. That would have been the only month it had a profitable month.

Senator RUDMAN. Of course, there was an incentive for these banks to handle these large "suitcase cash transactions," as I will call them, because if you handle enough of them at 1 percent, that is pretty good service charge.

In fact, if the money hadn't been withdrawn from the bank, what could you have done with it there?

Mr. STOCKS. That is something I think everybody should understand. The only way that the money would have value to the bank would be to take it back to the United States, deposit it in an account in the United States, then you would have the use of it by investing it in, well, the Eurodollar, or, what we normally use, was the Federal funds market.

Senator RUDMAN. So obviously the scheme for illegal money is for the person for the illegal funds to somehow, through a suitcase transaction, get them into your bank. You immediately reinvest them in an American bank, Eurodollars, and you receive interest on that money which you are allowed, of course, to do. Then, you pay a lesser amount of interest to your customer and that is precisely how they benefit from the transaction.

Mr. STOCKS. That would be one of the ways or if we were a little bank, obviously, they didn't want it at your bank, they could have it anyplace in the world they wanted to.

Senator RUDMAN. Obviously, under the present laws, it is extraordinarily easy to launder and hide illegal money.

Were you ever questioned when you left the country?

This is how much money, counsel, before us?

Three what?

Mr. WEILAND. $3.6 million.

Senator RUDMAN. You would carry how much, what was the most you ever carried?

Mr. STOCKS. I think maybe $600,000 or $700,000.

Senator RUDMAN. So that would be about fifth maybe, a fifth of this much?

What would you carry it in? A large suitcase?

Mr. STOCKS. No, briefcase.

Senator RUDMAN. Larger bills?

Mr. STOCKS. Yes.

Senator RUDMAN. What denomination bills would you carry?

Mr. STOCKS. Fifties and hundreds.

Mr. WEILAND. Mr. Chairman, this might be a good point to inject the question as to what was the largest deposit Oxford ever received, and, isn't it a fact, Mr. Stocks, that the depositor was satisfied to simply allow that money to remain in a demand deposit?

Mr. STOCKS. Yes. We were a very small bank, maybe having 10 or 12 people on the staff. So I opened most of the mail. One day I just opened an envelope, there was a check for $472,000 to deposit in two accounts in the bank.

At any time, our total deposits were, just guessing, let's say $800,000. So it represented about a 50-percent increase in our total deposit base. This was without any previous solicitation or anything else on the part of the people that the money was received from.

That money remained with us in one form or another without us paying any interest on it for, I would guess in excess of 6 months.

Senator RUDMAN. Was the depositor a United States citizen?

Mr. STOCKS. Yes.

Senator RUDMAN. The check was drawn on an American bank?

Mr. STOCKS. Yes.

Senator RUDMAN. Mr. Stocks, do you have any doubt whatsoever that right now there are essentially hundreds of these banks scattered throughout the Caribbean and other parts of the world engaging daily in these kinds of transactions?

Mr. STOCKS. Yes; there is no question about that. I was in the Cayman Islands as a tourist in 1968. The islands at that time were just about as sleepy a little place as the Turks and Caicos Islands are now. Now they have 300 banks, plus 30 full service banks.

Senator RUDMAN. They certainly are full service banks. They carry suitcases of cash back and forth to Miami. That is something most banks don't do.

I am going to recess the hearings until 2:30.

We have one remaining witness.

We thank you very much for your testimony. It certainly adds to the record.

I am going to suggest to counsel that during the recess we take this currency and have it sent back to wherever it belongs.

[Member present at the time of recess: Senator Rudman.]

[Whereupon at 1 p.m., the subcommittee recessed, to reconvene at 2:30 p.m., the same day.]

AFTER RECESS

[Senator present after the taking of a recess: Senator Roth.]

Chairman ROTH. The subcommittee will be in order.

We will have, at this time, following Mr. Stocks' testimony, the results of the staff investigation in this area. So at this time, I will swear in Mr. Morley and Mr. McLaughlin.

Will you please raise your right hand? Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. MORLEY. I do.

Mr. McLAUGHLIN. I do.

Chairman ROTH. Please be seated.

We will, of course, incorporate your entire statement.[1]

I appreciate your summarizing.

TESTIMONY OF CHUCK MORLEY, CHIEF INVESTIGATOR; AND TOM McLAUGHLIN, INVESTIGATOR, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. MORLEY. Thank you, Mr. Chairman. We thought it was important, during this investigation, to try to determine what types of individuals were using offshore bank accounts.

In that respect, it came to our attention in 1981, during a narcotics investigation that there were certain bank records available concerning the bank that Mr. Stocks was formerly president of. In accordance with that, in February 1982, the subcommittee subpenaed these records from the Southeast Bank in Miami, which was a correspondence bank of the Oxford Bank.

As a result of that subpena, we obtained rather limited records from 1975 through 1981 of the bank. We brought these records in and went through them fairly carefully and in that analysis, we came across some curious patterns, patterns that we recognized from previous hearings, particularly the narcotics hearings, and from the commodities hearings.

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[1] See p. 304 for the prepared staff statement.

This pattern consisted of numerous small checks being endorsed directly over to the Oxford Bank in the Turks and Caicos. These checks had the appearance of being sales items, gross receipt items from small businesses in the Midwest and from some farmers in the Midwest. We also saw a pattern of large, even amounts of checks coming directly out of that account back to these farmers. These withdrawals were generated payable to trusts.

As you recall, this is the type of pattern we found in our previous investigations as being used to launder funds in the United States. We took these checks down to Mr. Stocks in Miami, had him go over them to make sure we were not missing something, to see if he had any idea what these checks might represent. Mr. Stocks, in going through these checks——

Chairman ROTH. Would you try the other microphone? It is hard to hear. There is an echo in the room or something.

Mr. MORLEY. Is that better? It sounds about the same.

Chairman ROTH. It sounds about the same. You might as well use the other one.

Mr. MORLEY. Mr. Stocks identified some of the checks that we had as being from people that had vacation homes in the Turks.

Chairman ROTH. Who is Mr. Stocks?

Mr. MORLEY. Mr. Stocks——

Chairman ROTH. That is the one you had before?

Mr. WEILAND. When you were not here, Mr. Chairman.

Mr. MORLEY. He identified some of these people as having vacation homes in the Turks and Caicos or having businesses in the Turks and Caicos, which made the reason for having the bank account fairly logical. He also identified a significant number of people whom he said had been brought to the bank by Lowell Anderson.

Further, he identified some checks as being from people he was not familiar with at all.

Mr. Anderson, Lowell Anderson, was indicted 2 to 3 weeks ago in Wyoming on charges arising from his activities as a tax protest leader. It is our information that Mr. Anderson is a self-professed tax protest leader and a member of the posse comitatus and at one time was a member of the Patriots, both tax protest groups in the United States. Our investigation further showed that there were certain relationships between these individuals and Mr. Anderson, which is to say they made payments to Mr. Anderson or received payments back from Mr. Anderson. We also found other people who had no apparent tie to the tax protest movement. We had no evidence that they are in anyway associated with tax protest movements.

Based upon the results of this survey of the Oxford Bank, we decided we would look at some more offshore bank accounts. As a result, we obtained more correspondent records, via subpena. We obtained 1 week's worth of correspondent records on a Cayman bank, 1 week on a Bahamian bank and 1 week on the Bahamian bank's Cayman branch. We picked this week at random out of the summer months to hopefully not get so much tourist activity. During that survey, it took about 3 hours to go through the records. They were on microfilm.

Again, one account stood out as having the exact same pattern, which is to say, numerous small, odd payments of checks being endorsed directly into a Cayman bank account. In this case, we did not have the withdrawals noted. We followed up on that investigation and found that this was a music business in the Midwest. It sells reeds, devices put on saxophones, and so forth.

The business is apparently owned or operated by a doctor in the Midwest. We attempted to contact the doctor. We were unable to. However, we did talk with his attorney, who could provide no explanation and as yet has not gotten back to us with any explanation of the nature of these deposits. I would like to say that our survey of accounts is by no means a statistical sample. I am not able to say at this point that these items that went offshore are criminal items. I am not able to say that they result from criminal activity or that they are tax evasion funds. I do not have enough information to say that.

However, I can say that, based upon the literally hundreds of people we talked to, and based upon what Mr. Stocks testified to earlier today, there appears to be no valid legal reason why these people would make use of these accounts the way they apparently did.

We had the option of subpenaing these people to testify. However, our conversations with them indicated that they would decline to testify before the subcommittee on constitutional grounds, specifically the fifth amendment to the Constitution. Therefore, we felt it would not necessarily be productive to bring them in.

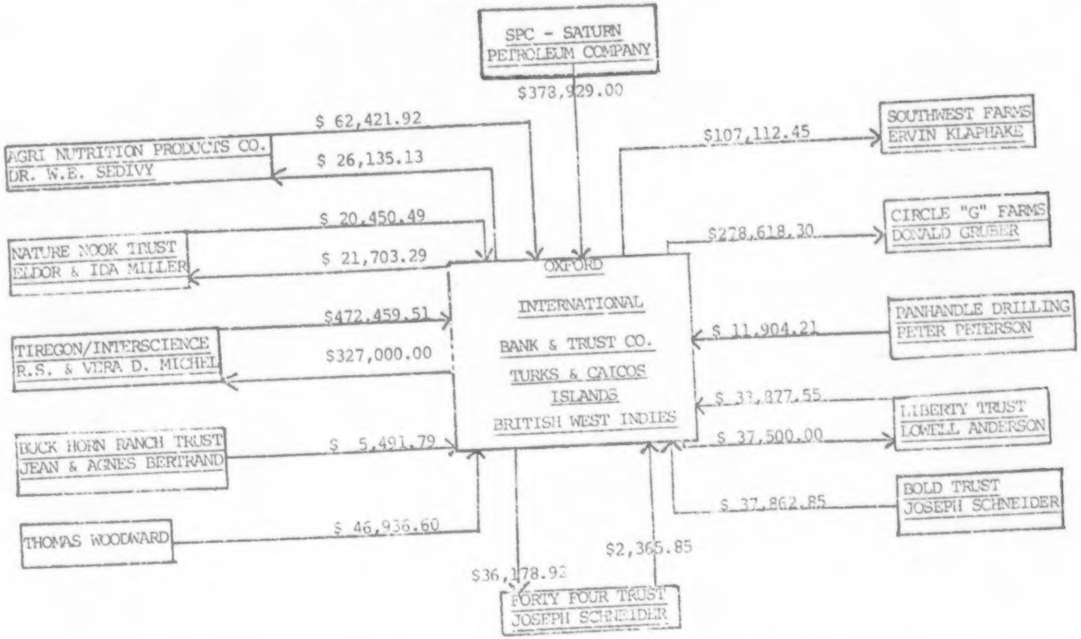
At this time, I would like to have Mr. McLaughlin tell you a little bit about the details of what we found in these accounts.

Mr. McLAUGHLIN. Thank you, Mr. Chairman. The subcommittee staff's analysis of the account activity of U.S. account holders at the Oxford Bank is depicted by the charts to my right, before the subcommittee entitled "Case study: Mid-America Goes Offshore."

[The charts referred to were marked "Exhibits Nos. 3 and 4," for reference, and follow:]

EXHIBIT NO. 3

CASE STUDY: MID-AMERICA GOES OFFSHORE

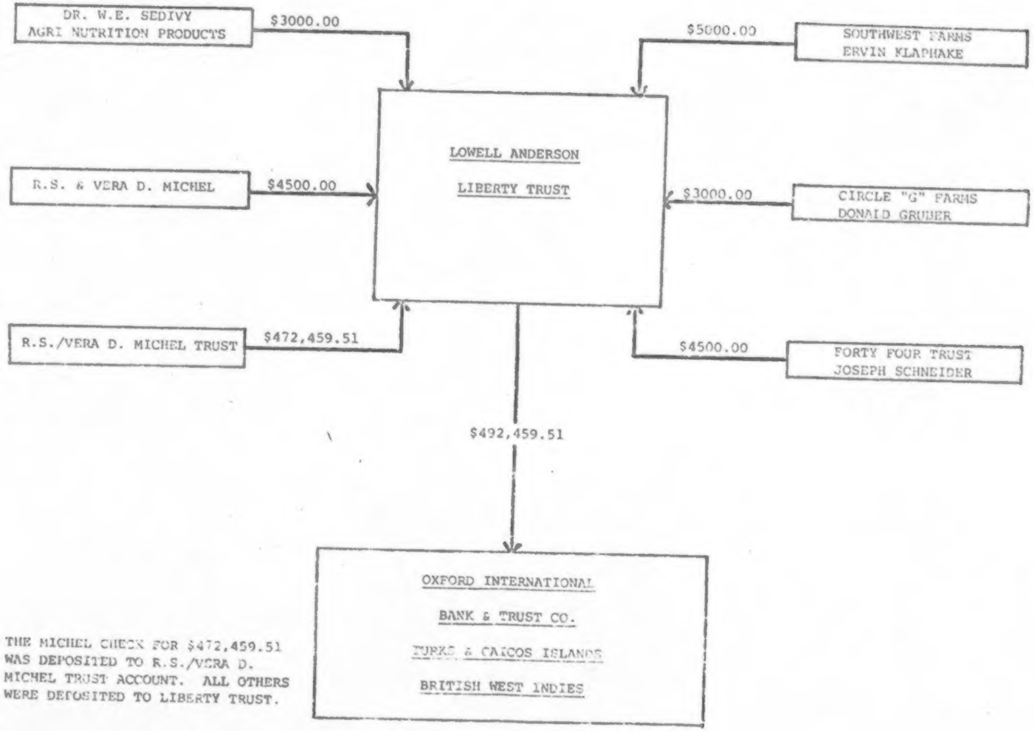

SPC - SATURN PETROLEUM COMPANY
$378,929.00
OXFORD INTERNATIONAL BANK & TRUST CO. TURKS & CAICOS ISLANDS BRITISH WEST INDIES
AGRI NUTRITION PRODUCTS CO. DR. W.E. SEDIVY
$ 62,421.92
$ 26,135.13
NATURE NOOK TRUST ELDOR & IDA MILLER
$ 20,450.49
$ 21,703.29
TIREGON/INTERSCIENCE R.S. & VERA D. MICHEL
$472,459.51
$327,000.00
BUCK HORN RANCH TRUST JEAN & AGNES BERTRAND
$ 5,491.79
THOMAS WOODWARD
$ 46,936.60
FORTY FOUR TRUST JOSEPH SCHNEIDER
$36,178.92
$2,365.85
SOUTHWEST FARMS ERVIN KLAPHAKE
$107,112.45
CIRCLE "G" FARMS DONALD GRUBER
$278,618.30
PANHANDLE DRILLING PETER PETERSON
$ 11,904.21
LIBERTY TRUST LOWELL ANDERSON
$ 33,877.55
$ 37,500.00
BOLD TRUST JOSEPH SCHNEIDER
$ 37,862.85

NEGOTIATED=$1,072,699.77

WITHDRAWN=$834,248.09

EXHIBIT NO. 4

PAYMENTS TO ALLEGED TAX PROTEST LEADER USING OFFSHORE BANK


DR. W.E. SEDIVY
AGRI NUTRITION PRODUCTS
$3000.00
R.S. & VERA D. MICHEL
$4500.00
R.S./VERA D. MICHEL TRUST
$472,459.51
LOWELL ANDERSON
LIBERTY TRUST
$5000.00
SOUTHWEST FARMS
ERVIN KLAPHAKE
$3000.00
CIRCLE "G" FARMS
DONALD GRUBER
$4500.00
FORTY FOUR TRUST
JOSEPH SCHNEIDER
$492,459.51
OXFORD INTERNATIONAL
BANK & TRUST CO.
TURKS & CAICOS ISLANDS
BRITISH WEST INDIES

NOTE: THE MICHEL CHECK FOR $472,459.51 WAS DEPOSITED TO R.S./VERA D. MICHEL TRUST ACCOUNT. ALL OTHERS WERE DEPOSITED TO LIBERTY TRUST.

Mr. McLaughlin. The individuals and businesses which were the subject of this phase of our investigation are displayed along with the deposit and withdrawal activity of each account. The red lines represent deposits, blue lines represent withdrawals.

The total timeframe covered by this chart is 10 months, however the average activity shown is just a little over 6 months. As you can see, during this time period these Oxford account holders deposited over $1 million to their accounts and withdrew over $800,000 from their accounts. These figures were derived from our analysis of the records available to the subcommittee. These records cannot be construed to represent the entire history of each account.

While these totals may not seem high when considering international financial transactions or when considering this morning's testimony, we must remember that we are dealing with a limited number of accounts at one offshore bank on a tiny island in the British West Indies. When considered in relationship to the total number of offshore financial institutions worldwide, these figures become staggering.

As stated by Mr. Morley, the subcommittee staff observed an interesting pattern of deposit and withdrawal activity in many of the American account holders at the Oxford Bank. Directing your attention, Mr. Chairman, to the portion of the chart dealing with the R. S. and Vera D. Michel Trust account, we confirmed through investigation that Mr. Ray Michel was a principal in both Tiregon Leasing Co. and Interscience, Inc. The activity of this account provides a good example of how an offshore account might be used. In fact, this is the account which Mr. Stocks referred to in his testimony this morning. The deposit total, as you can see, of over $472,000, was accomplished in seven transactions between June 1978 and August 1978. Beginning in October 1978 through March 1979, a total of $327,000 was received from the Oxford Bank in the form of checks payable to Tiregon Leasing and Interscience, Inc. Although Mr. Michel refused to answer our questions regarding his Oxford Bank account, it is possible that moneys were being deposited into the trust account and then withdrawn in the form of payments to two corporations controlled by Mr. Michel.

Directing your attention, Mr. Chairman, to the Nature Nook Trust account of Eldor and Ida Miller, although the deposit and withdrawal figures are not high, it is important to note that these figures represent 8 months of activity and involve over 400 separate transactions. The withdrawal figure of $21,703.29 was accomplished in just 12 transactions with the remainder of the transactions being deposits.

Virtually all of the items negotiated at Oxford by the Nature Nook Trust were small third party checks from people in the United States. Since he refused to answer our questions, we can only speculate as to why Mr. Miller, a farmer from North Dakota, used an account at the Oxford Bank in the Turks and Caicos Islands.

In the interest of time, Senator, I would just briefly mention two or three other accounts. Similar patterns of activity were observed in several of the other accounts, including the Agri Nutrition Products account of Dr. Wilmee Sedivy. This account involved 36 total transactions, 35 were deposits, one accounted for the entire amount withdrawn. The Liberty Trust account of Mr. Lowell Anderson involved 56 transactions, 54 deposits, and 2 withdrawals.

We determined, through investigation, that the Forty Four Trust account at the Oxford Bank was controlled by Joseph Schneider of Hay Springs, Nebr. Less than 2 weeks ago, upon receipt of additional subpenaed U.S. bank records, we discovered that Mr. Schneider also controlled the Bold Trust account at the Oxford Bank. Interestingly, all activity we found for the Bold Trust account was in the form of negotiations; that is, deposits or checks cashed at the Oxford Bank, whereas 14 or 15 transactions of the Forty Four Trust account were withdrawals. Since Mr. Schneider declined to provide testimony to the subcommittee, again we can only speculate as to why he maintained two accounts at the Oxford Bank and why he used them in the manner in which he did.

Mr. Chairman, I would like to offer this book for the record. It contains copies of all of the items negotiated and withdrawn from the accounts at the Oxford Bank as depicted by the chart before the subcommittee.

[The book referred to was marked "Exhibit No. 5," for reference, and is retained in the files of the subcommittee.]

As stated earlier, the subcommittee staff atempted to interview these Oxford Bank account holders to determine their reasons for maintaining an offshore bank account and most importantly, to solicit their cooperation in our investigation. After extreme effort, we succeeded in arranging only one personal interview with Dr. Wilmer Sedivy of Nebraska. All other account holders either indicated their intent to plead the fifth amendment or avoided contact with the subcommittee.

In written responses to our request for cooperation, and in rather restricted telephone interviews with these individiuals, subcommittee staff members heard similar negative statements about the Internal Revenue Service and the U.S. banking industry. Several characterized the IRS as the "Gestapo" in the United States and most expressed distrust for the entire U.S. banking system. Some explained that their reason for banking offshore was to gain privacy of their financial affairs. And three expressed distaste for their offshore banking experiences. However, none would elaborate further. Our own personal interview with Dr. Sedivy, who is a doctor of veterinary medicine, deteriorated into a discourse by Sedivy on the unconstitutionality of the IRS, the Federal Reserve Board, income taxes and paper money. Dr. Sedivy would not provide any indication that his Agri Nutrition Co. ever existed in any form other than his Caribbean bank account.

Our investigation of these 11 Oxford Bank account holders revealed the following. At least six of these individuals appear to be associated in some way with the agriculture industry. At least nine are or have been under IRS and or grand jury investigation. Lowell Anderson, the tax protester mentioned earlier by Mr. Morley, sold offshore trusts to at least three of these accountholders and lastly Lowell Anderson was involved in some way with at least six other accountholders. This last fact is presented in the second chart before the subcommittee entitled "Payments to Alleged Tax Protest Leader Using Offshore Bank." Our analysis of the subpenaed bank records revealed checks deposited to the Liberty Trust account of Lowell Anderson at the Oxford Bank from the following individuals: Dr. Wilmer Sedivy, Agri

Nutrition Products; Mr. Ray Michel, R.S. and Vera D. Michel Trust; Ervin Klaphake, Southwest Farms; Donald Gruber, Circle "G" Farms; and Joseph Schneider, Forty Four and Bold Trust. In addition we discovered that a check for $472,159.51 was deposited to the R.S. and Vera D. Michel Trust account at the Oxford. This check being endorsed not only in the name of the payees, but also by Mr. Lowell Anderson.

We have information that three of these individuals purchased trusts from Lowell Anderson and we assume that these checks could represent at least partial payment. The reason I say partial payment is because of a recent indictment of Mr. Anderson which revealed that at least one individual paid $20,000 for the Lowell Anderson Trust.

Clearly these similarities and connections are not coincidental. Other Government sources confirm that the responses we received from these individuals are similar to the responses given by those in the tax protest movement.

Our investigation focused on only a handful of individuals, believed to be average American citizens, involved with one small bank in the British West Indies. This and other evidence collected to date indicates the involvement of average U.S. citizens in offshore banking is widespread and growing. If the above cases are indicative, the amount of money involved could be enormous.

During our investigation of U.S. accountholders at the Oxford Bank, we developed several confidential sources of information, who described the tax protest movement and its involvement with offshore banking.

The subcommittee staff has found that certain individuals persuade susceptible citizens that they can legally avoid taxation by placing their assets in an offshore trust. For a few hundred dollars, a trust is created in an obscure place like the Turks and Caicos Island and is then sold for several thousand dollars to an individual in the United States. A trust account is established with a bank such as the Oxford Bank to facilitate deposits and withdrawals from the account. Some promoters of trust schemes emphasize that strict secrecy laws of the offshore countries shield the identity of the trust owner and thereby insulate him and his assets from investigation by the IRS. If the individual has difficulty with the IRS, the conmen continue their exploitation by advising how the IRS can be expected to proceed and how the taxpayer should respond. When the IRS proceeds exactly as advised, the trust owner's faith in these conmen is reinforced.

The Oxford bank phase of our investigation raised as many questions as it answered. For this reason, we are continuing our inquiry into two areas. First, an association which is alleged by subcommittee sources to be involved in the conversion of its member's dollars into gold and silver. The concept of insuring the value of ones money through the purchase of precious metals is attractive to people who distrust the American banking system and question the legality of the U.S. dollar. Second, as, Mr. Chairman, you noted at yesterdays hearing, the staff is concerned about evidence indicating that certain tax protest groups are becoming more radical. Sometimes arming themselves with automatic weapons.

This evidence was tragically brought to nationwide attention in mid-February 1983, when two U.S marshals were killed and three other officers were wounded in a burst of automatic weapons fire while attempting to arrest Gordon Kahl, a convicted tax protester, for parole violations. Kahl is a member of the posse comitatus tax protest group. Lowell Anderson, a central figure in our investigation, is also apparently a member of the posse comitatus.

That concludes my testimony, Mr. Chairman. Thank you very much.

Chairman ROTH. As I understand your testimony today, you are dealing primarily with a group of so-called tax protesters, all of these people are more or less part of that movement?

Mr. MORLEY. Not all of them, no sir. I believe most of them are. We found also several otherwise apparently legitimate businessmen. We could find no tie between them and the tax protest movement. That is not to say that it does not exist. But we could not find evidence of it.

Chairman ROTH. When we make statements that it is widespread, has any agency of Government or anyone else attempted to establish how widespread it is? To what extent may American taxpayers be involved in this scheme? Have you seen any studies along that line?

Mr. MORLEY. I have not seen them, no sir. But I understand, I believe, the Commissioner of IRS testified yesterday that in their opinion, this was a rapidly growing phenomenon, both the tax protest movement and the use of offshore companies and banks by U.S. citizens. Yes, according to our information, tax protest groups have quadrupled in size in 3 years. IRS reported it grew from 6,000 in 1978 to 27,000 in 1981. This is according to an article in the Pittsburgh Press on tax protesters.

Apparently it is an article quoting the IRS. I cannot vouch for its validity.

Chairman ROTH. I would like you to go through, give a simple illustration for the purpose of the record, exactly how this works and what could be the legitimate purpose? There are obviously legitimate purposes in sending money overseas.

Mr. MORLEY. Yes, sir, I think there are. As I have said, we talked to a large number of experts and in almost every case, I posed that very question to them because we, of course, did not want to interfere with the chain of commerce. It is their virtually unanimous opinion that a person would have a legitimate use of an offshore bank or company under several circumstances. One would be that they were putting the money into the Eurodollar market, Eurocurrency market, otherwise involving themselves in European bond deals.

Another situation would be if a person had a legitimate business offshore, if they were importers or exporters or have a business in the Turks and Caicos. Another one would be if they were a vacationer to a place offshore. Other than that, I have come up against a blank wall as to other viable reasons. So it appears to me that unless these people are in one of those niches, the only other possible reason that I could draw would be that it was for tax purposes, by that I mean tax evasion purposes.

Chairman ROTH. Mr. Weiland.

Mr. WEILAND. Mr. Chairman, I have really no questions. I would simply like to have marked as exhibits, the two charts these gentlemen referred to earlier, numbered appropriately and submitted into the record at the appropriate point.

[The charts referred to marked exhibits Nos. 3 and 4 appear on pages 101 and 102.]

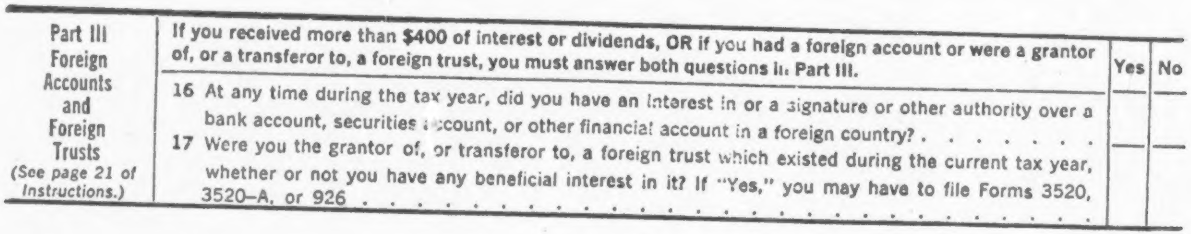
Chairman Roth. Then we have the documents of Mr. McLaughlin as part of the record.

Mr. Weiland. Part of the record, but not for republication. I would also like to say, we would like to submit for the record, an identification of certain staff documents and whatnot that we would like to appropriate into the record, again most not for republication, but for availability to law enforcement personnel, et cetera.

Chairman Roth. So ordered.

[The material referred to was marked "Exhibits No.'s 6 through 15," for reference. Exhibits 6, 7, 9, 11, and 12, are retained in the files of the subcommittee. Exhibits 8, 10, 13, 14, and 15 follow:]

EXHIBIT NO. 8



Part III Foreign Accounts and Foreign Trusts *(See page 21 of Instructions.)*	If you received more than **$400** of interest or dividends, **OR** if you had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must answer both questions in Part III.	Yes	No
	16 At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country?		
	17 Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926		

SUMMARY OF REPLIES TO QUESTIONS ON FOREIGN ACCOUNTS AND TRUSTS

Year	Yes to Both Questions	Yes to Bank Account; No/No Reply to Other	Yes to Trust Only	At Least One "No" Box Checked	Total Filing Population
CY 1981	9,431	167,623	4,293	18,775,817	95,284,813
CY 1980	3,803	151,259	642	16,689,151	93,902,469
CY 1979	6,330	134,864	871	15,354,353	92,694,302

Source: unpublished SOI data from individual returns for years noted; based on statistical samples

EXHIBIT NO. 10

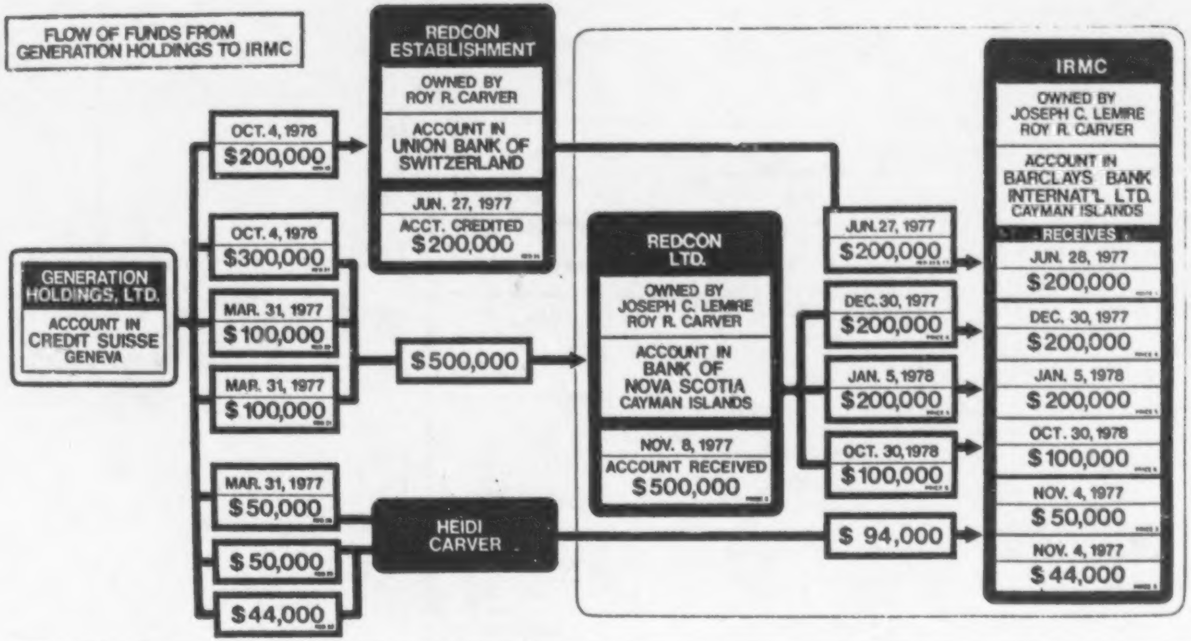

FLOW OF FUNDS FROM GENERATION HOLDINGS TO IRMC
GENERATION HOLDINGS, LTD.
ACCOUNT IN CREDIT SUISSE GENEVA
OCT. 4, 1976
$200,000
OCT. 4, 1976
$300,000
MAR. 31, 1977
$100,000
MAR. 31, 1977
$100,000
MAR. 31, 1977
$50,000
$50,000
$44,000
REDCON ESTABLISHMENT
OWNED BY ROY R. CARVER
ACCOUNT IN UNION BANK OF SWITZERLAND
JUN. 27, 1977
ACCT. CREDITED
$200,000
$500,000
HEIDI CARVER
REDCON LTD.
OWNED BY JOSEPH C. LEMIRE ROY R. CARVER
ACCOUNT IN BANK OF NOVA SCOTIA CAYMAN ISLANDS
NOV. 8, 1977
ACCOUNT RECEIVED
$500,000
JUN. 27, 1977
$200,000
DEC. 30, 1977
$200,000
JAN. 5, 1978
$200,000
OCT. 30, 1978
$100,000
$ 94,000
IRMC
OWNED BY JOSEPH C. LEMIRE ROY R. CARVER
ACCOUNT IN BARCLAYS BANK INTERNAT'L LTD. CAYMAN ISLANDS
RECEIVES
JUN. 28, 1977
$200,000
DEC. 30, 1977
$200,000
JAN. 5, 1978
$200,000
OCT. 30, 1978
$100,000
NOV. 4, 1977
$50,000
NOV. 4, 1977
$44,000

EXHIBIT NO. 10

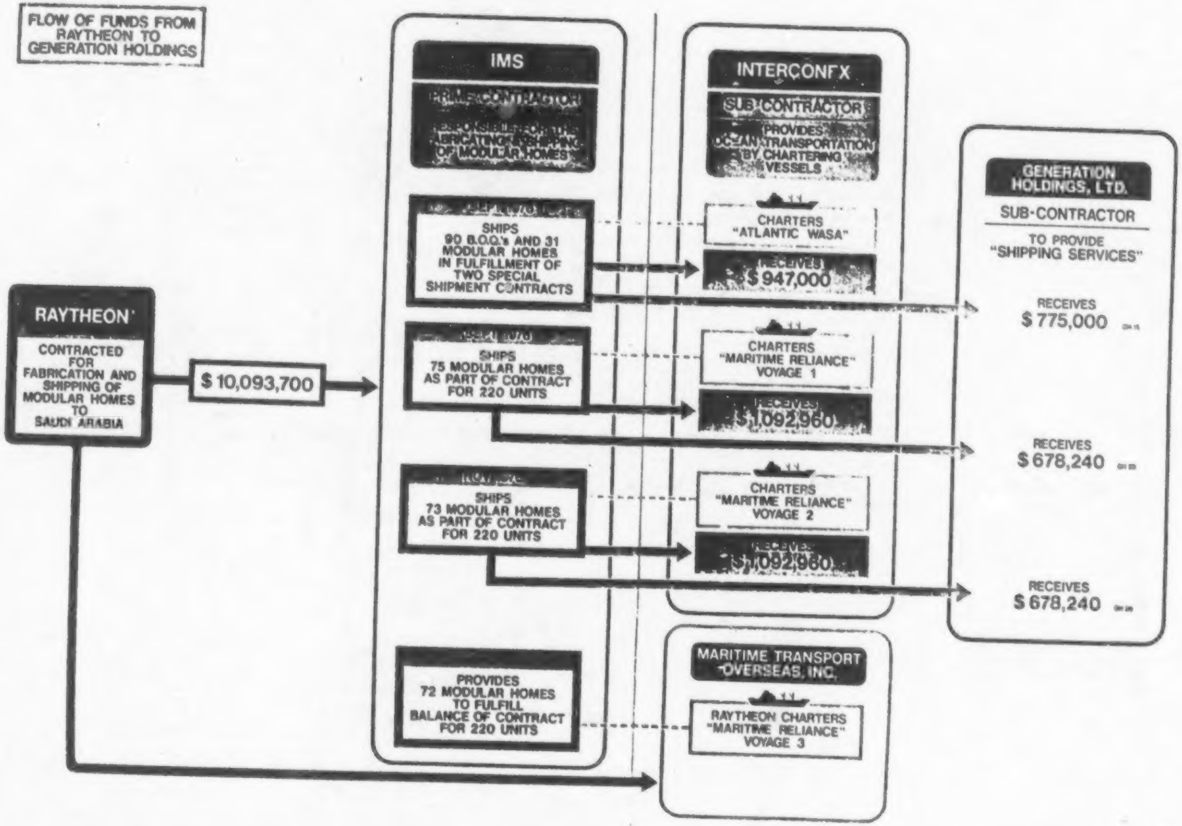
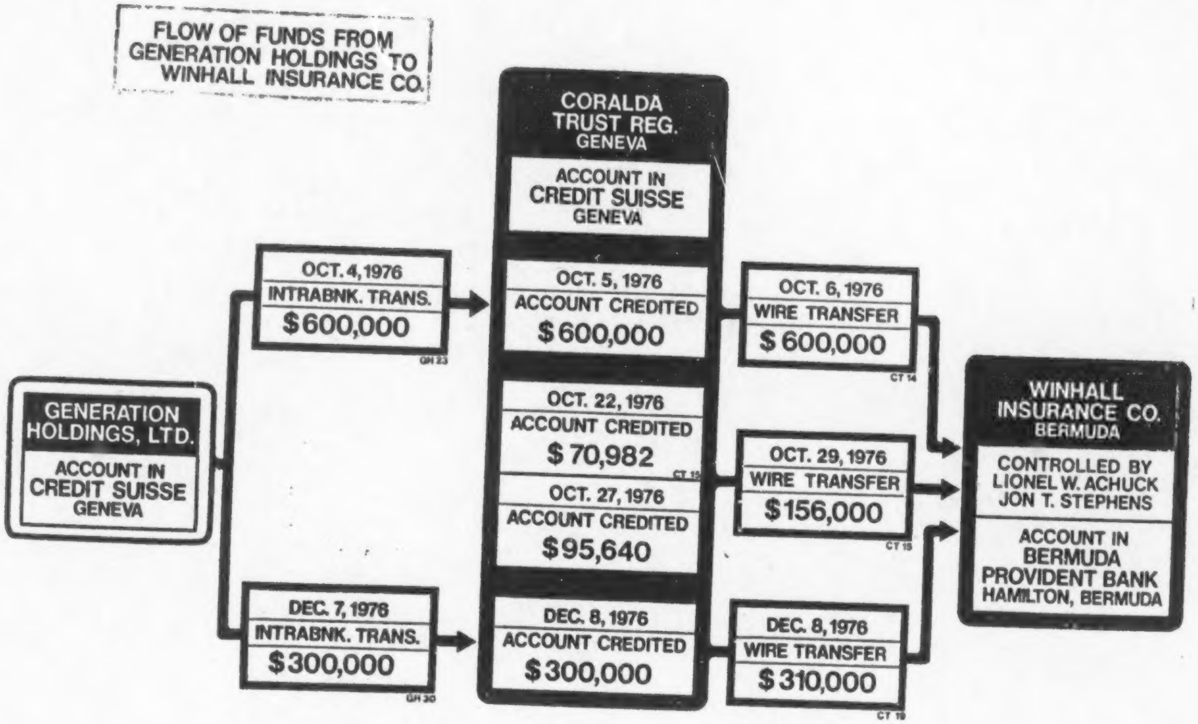

FLOW OF FUNDS FROM RAYTHEON TO GENERATION HOLDINGS
RAYTHEON
CONTRACTED FOR FABRICATION AND SHIPPING OF MODULAR HOMES TO SAUDI ARABIA
$ 10,093,700
IMS
PRIME CONTRACTOR
OF MODULAR HOMES
SHIPS 90 B.O.Q.'s AND 31 MODULAR HOMES IN FULFILLMENT OF TWO SPECIAL SHIPMENT CONTRACTS
SHIPS 75 MODULAR HOMES AS PART OF CONTRACT FOR 220 UNITS
SHIPS 73 MODULAR HOMES AS PART OF CONTRACT FOR 220 UNITS
PROVIDES 72 MODULAR HOMES TO FULFILL BALANCE OF CONTRACT FOR 220 UNITS
INTERÇONFX
SUB-CONTRACTOR
PROVIDES OCEAN TRANSPORTATION BY CHARTERING VESSELS
CHARTERS "ATLANTIC WASA"
RECEIVES $ 947,000
CHARTERS "MARITIME RELIANCE" VOYAGE 1
RECEIVES $1,092,960
CHARTERS "MARITIME RELIANCE" VOYAGE 2
RECEIVES $1,092,960
MARITIME TRANSPORT OVERSEAS, INC.
RAYTHEON CHARTERS "MARITIME RELIANCE" VOYAGE 3
GENERATION HOLDINGS, LTD.
SUB-CONTRACTOR
TO PROVIDE "SHIPPING SERVICES"
RECEIVES $ 775,000
RECEIVES $ 678,240
RECEIVES $ 678,240

EXHIBIT NO. 10



FLOW OF FUNDS FROM GENERATION HOLDINGS TO WINHALL INSURANCE CO.

GENERATION HOLDINGS, LTD.
ACCOUNT IN CREDIT SUISSE GENEVA
OCT. 4, 1976
INTRABNK. TRANS.
$600,000
GH 23
DEC. 7, 1976
INTRABNK. TRANS.
$300,000
GH 30
CORALDA TRUST REG. GENEVA
ACCOUNT IN CREDIT SUISSE GENEVA
OCT. 5, 1976
ACCOUNT CREDITED
$600,000
OCT. 22, 1976
ACCOUNT CREDITED
$70,982
CT 15
OCT. 27, 1976
ACCOUNT CREDITED
$95,640
DEC. 8, 1976
ACCOUNT CREDITED
$300,000
OCT. 6, 1976
WIRE TRANSFER
$600,000
CT 14
OCT. 29, 1976
WIRE TRANSFER
$156,000
CT 15
DEC. 8, 1976
WIRE TRANSFER
$310,000
CT 19
WINHALL INSURANCE CO. BERMUDA
CONTROLLED BY LIONEL W. ACHUCK JON T. STEPHENS
ACCOUNT IN BERMUDA PROVIDENT BANK HAMILTON, BERMUDA

EXHIBIT NO. 13

I further announce that, if present and voting, the Senator from Hawaii (Mr. Matsunaga) and the Senator from Arkansas (Mr. Pryor), would each vote "yea."

The PRESIDING OFFICER. Are there any other Senators in the Chamber who desire to vote?

The result was announced—yeas 69, nays 27, as follows:

[Rollcall Vote No. 121 Leg.]

YEAS—69

Abdnor
Andrews
Armstrong
Baker
Baucus
Bentsen
Boren
Boschwitz
Brady
Bumpers
Burdick
Byrd,
Harry F., Jr.
Byrd, Robert C.
Cannon
Chiles
Cochran
D'Amato
DeConcini
Denton
Dixon
Dole
Domenici
Eagleton
East
Exon
Ford
Garn
Glenn
Grassley
Hatch
Hatfield
Hayakawa
Heflin
Helms
Hollings
Huddleston
Humphrey
Inouye
Jepsen
Johnston
Kassebaum
Kasten
Laxalt
Leahy
Levin
Mattingly
McClure
Melcher
Murkowski
Nickles
Nunn
Pressler
Quayle
Randolph
Riegle
Roth
Rudman
Sasser
Schmitt
Simpson
Stafford
Stennis
Stevens
Symms
Thurmond
Tower
Wallop
Warner
Zorinsky

NAYS—27

Biden
Bradley
Chafee
Cohen
Cranston
Danforth
Dodd
Durenberger
Gorton
Hart
Hawkins
Heinz
Jackson
Kennedy
Long
Lugar
Mathias
Metzenbaum
Mitchell
Moynihan
Packwood
Pell
Proxmire
Sarbanes
Specter
Tsongas
Weicker

NOT VOTING—4

Goldwater
Matsunaga
Percy
Pryor

So the concurrent resolution (S. Con. Res. 60) was agreed to, as follows:

S. Con. Res. 60

Resolved by the Senate (the House of Representatives concurring), That the Congress disapproves the final rule promulgated by the Federal Trade Commission dealing with the matter of the trade regulation rule relating to the sale of used motor vehicles, which final rule was submitted to the Congress on January 28, 1982.

RECESS UNTIL 3 P.M.

Mr. BAKER. Mr. President, I ask unanimous consent that the Senate stand in recess until the hour of 3 p.m. today.

There being no objection, the Senate, at 2:26 p.m., recessed until 3 p.m.; whereupon, the Senate reassembled when called to order by the Presiding Officer (Mr. Helms).

The PRESIDING OFFICER. The Chair, in its capacity as a Senator from North Carolina, suggests the absence of a quorum.

The clerk will call the roll.

The legislative clerk proceeded to call the roll.

Mr. BAKER. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER (Mr. Durenberger). Without objection, it is so ordered.

ROUTINE MORNING BUSINESS

Mr. BAKER. Mr. President, I ask unanimous consent that there now be a brief period for the transaction of routine morning business, not to extend past 3:15 p.m., in which Senators may speak.

The PRESIDING OFFICER. Without objection, it is so ordered.

THE U.S. FOREIGN AID PROGRAM: CONGRESS HAS BROKEN THE BANK AND THE BACKS OF AMERICAN TAXPAYERS

Mr. HELMS. Mr. President, several months ago a friend in North Carolina asked a question I could not answer—but I promised that I would find the answer and report back to him.

Frankly, it did not occur to me at the time that nowhere in the Federal Government, with all of its experts, with all its computers, was the answer to his question to be found.

However, after months of research and computations, I finally have an answer.

The question: How much, including interest on the money borrowed by the U.S. Government to finance the program, has our foreign aid program cost the American taxpayers?

The answer—and I suggest that the distinguished Presiding Officer hold onto his hat—is: $2,304,257,900,000.

Let me spell it out, Mr. President: 2 trillion, 304 billion, 257 million, 900 thousand dollars of the American taxpayers' money.

Mr. President, when I reached the end of literally months of inquiries, calculations, searching of official documents, up popped that total figure—one so enormous that I simply could not believe it. I sent it back to be checked again.

Bear in mind the precise question that was asked of me: How much, including interest on the money borrowed by the U.S. Government to finance the program, has our foreign aid program cost the taxpayers? My friend in North Carolina insisted, correctly, that any honest assessment of the cost would necessarily include the interest because the Federal Government was running a deficit almost every year, and therefore was in effect borrowing the money it was giving away to foreign countries.

To be very technical in the context in which an economist would put it—the present cost of past expenditures equals the nominal dollar amount plus the compound interest that would have been earned in the financial markets. Today's cost includes alternative uses of those funds over the intervening period.

Mr. President, my friend makes a point that should be remembered by Members of Congress when they so freely vote to create and expand multibillion dollar Federal programs of every type. The point is this: These programs would be expensive even if the Federal Government were operating on a balanced budget. But when Congress approves enormous deficits, and when interest on the borrowed money is compounded year after year, the real costs of Federal programs soars into the stratosphere.

And that, Mr. President, is why Congress is to blame for the trillion dollar national debt now smothering the U.S. economy. Think about it, Mr. President. This year, it will cost the U.S. taxpayers about $115 billion just to pay the interest—1 year's interest—on money that the Federal Government has spent in excess of income. Would it not be delightful if we did not have to worry about that $115 billion? The news media and President Reagan's other political critics—who falsely claim that Ronald Reagan is responsible for the huge Federal deficit—would not be able to mislead the American people, because the Federal budget would today be relatively easy to balance, inflation would be less of a problem, the U.S. economy would not be in distress, the unemployment level would be lower, and production would be setting new records.

So, Mr. President, the folly of foreign aid since 1946, the year the program began, is an alarming symptom of what is wrong with the Federal Government—and the country.

The total cost of the foreign aid program—since its inception in 1946 and including the estimated nearly $10 billion cost for fiscal year 1981—the actual figures for fiscal year 1981 are not yet available—is $286,467,000,000. This figure represents total Federal outlays in nominal dollars, that is, the dollars expended in each of the years specified.

More than $286 billion, Mr. President. But that is before we factor in the equivalent interest on the money borrowed in the American taxpayers' name to spread this money across the face of the Earth.

As I said at the outset, the total cost of foreign aid, including interest, since 1946, is $2,304,257,900,000—2 trillion, 304 billion, 257 million, 900 thousand dollars.

Mr. President, to which countries, and how much for each, has this enormous sum been devoted? I have a breakdown, country by country, and I ask unanimous consent that it be printed in the Record at this point.

There being no objection, the material was ordered to be printed in the Record, as follows:

Aid given by the United States for the years 1946-81

Country:	*Total aid given*
Afghanistan	$542,331,000
Albania	20,400,000
Algeria	203,282,000
Andorra	0
Angola	8,886,000

Antigua	0
Argentina	162,826,000
Australia	122,586,000
Austria	1,236,760,000
Bahamas	301,000
Bahrain	2,408,000
Bangladesh	1,983,924,000
Barbados	3,334,000
Belgium	1,897,491,000
Belize	10,346,000
Benin	48,516,000
Bermuda	0
Bhutan	816,000
Bolivia	888,077,000
Botswana	118,840,000
Brazil	2,968,430,000
Brunei	0
Bulgaria	0
Burma	197,000,000
Burundi	34,742,000
Cambodia (Kampuchea)	2,180,846,000
Cameroon	39,723,000
Canada	30,500,000
Cape Verde	37,326,000
Central African Republic	15,829,000
Chad	88,240,000
Chile	1,388,092,000
China	486,000
Colombia	1,898,319,000
Comoros	300,000
Congo	10,427,000
Cook Islands	0
Costa Rica	271,994,000
Cuba	30,130,000
Cyprus	149,280,000
Czechoslovakia	193,001,000
Denmark	921,970,000
Djibouti	4,716,000
Dominican Republic	891,962,000
Ecuador	430,714,000
Egypt	7,874,518,000
El Salvador	384,871,000
Equatorial Guinea	0
Ethiopia	667,704,000
Falkland Islands	0
Faroe Islands	0
Fiji	0
Finland	57,068,000
France	8,466,839,000
French Antilles and Guiana	0
French Polynesia	0
Gabon	18,414,000
The Gambia	22,825,000
German Democratic Republic	800,000
Germany, Federal Republic of	4,980,422,000
Ghana	381,312,000
Gibraltar	0
Greece	5,342,484,000
Greenland	0
Grenada	0
Guadeloupe	0
Guatemala	492,362,000
Guinea	162,001,000
Guinea-Bissau	14,958,000
Guyana	136,806,000
Haiti	279,167,000
Honduras	356,680,000
Hong Kong	43,800,000
Hungary	32,700,000
Iceland	82,184,000
India	10,268,489,000
Indonesia	3,188,872,000
Iran	2,170,628,000
Iraq	35,584,000
Ireland	146,524,000
Israel	18,490,873,000
Italy	5,884,190,000
Ivory Coast	46,863,000
Jamaica	192,501,000
Japan	3,950,707,000
Jordan	2,417,897,000
Kenya	394,459,000
Kiribati	0
Korea (North)	0
Korea (South)	13,825,488,000
Kuwait	0
Laos	2,809,312,000
Lebanon	299,756,000
Lesotho	78,824,000
Liberia	329,926,000
Libya	230,115,000
Liechtenstein	0
Luxembourg	0
Macao	0
Madagascar	21,186,000
Malawi	64,280,000
Malaysia	237,308,000
Maldives	0
Mali	148,838,000
Malta	84,409,000
Martinique	0
Mauritania	81,282,000
Mauritius	23,532,000
Mexico	341,867,000
Monaco	0
Mongolia	0
Morocco	1,332,612,000
Mozambique	62,038,000
Namibia	0
Nauru	0
Nepal	290,924,000
Netherlands	2,312,211,000
Netherlands Antilles	0
New Caledonia	0
New Zealand	8,582,000
Nicaragua	370,080,000
Niger	119,842,000
Nigeria	408,414,000
Norway	1,245,549,000
Oman	32,841,000
Pakistan	5,684,567,000
Panama	439,547,000
Papua New Guinea	322,000
Paraguay	211,787,000
Peru	983,899,000
Philippines	3,131,494,000
Poland	539,300,000
Portugal	1,328,246,000
Qatar	0
Reunion	0
Romania	22,435,000
Rwanda	29,772,000
Ryukyu Islands	413,725,000
St. Christopher-Nevis-Anguilla	0
St. Lucia	0
St. Vincent and the Grenadines	0
San Marino	0
Sao Tome and Principe	566,000
Saudi Arabia	324,096,000
Senegal	163,180,000
Seychelles	3,151,000
Sierra Leone	82,978,000
Singapore	21,962,000
Solomon Islands	0
Somalia	219,292,000
South Africa	1,300,000
Spain	3,537,406,000
Sri Lanka	508,887,000
Sudan	296,238,000
Surinam	5,831,000
Swaziland	43,641,000
Sweden	109,037,000
Switzerland	0
Syria	588,015,000
Taiwan	6,567,227,000
Tanzania	271,446,000
Thailand	2,407,318,000
Togo	50,152,000
Tonga	0
Trinidad and Tobago	40,864,000
Tunisia	1,071,312,000
Turkey	8,361,345,000
Tuvalu	0
Uganda	53,474,000
United Arab Emirates	0
United Kingdom	8,779,506,000
Upper Volta	139,045,000
Uruguay	248,859,000
U.S.S.R.	186,400,000
Vanuatu	0
Venezuela	253,568,000
Vietnam	23,261,456,000
Wallis and Futuna	0
Western Sahara	0
Western Samoa	9,841,000
Yemen (North)	125,000,000
Yemen (South)	4,500,000
Yugoslavia	2,831,962,000
Zaire	784,558,000
Zambia	182,527,000
Zimbabwe	29,905,000
Central Treaty Organization	30,624,000
Near East and South Asia Regional	566,043,000
WestIndies-Caribbean Regional	182,143,000
ROCAP (Regional Office, Central America and Panama)	255,116,000
Latin America Regional	867,102,000
Indochina Associated States	1,557,997,000
East Asia Regional	356,520,000
Entente States	38,282,000
Portuguese States in Africa	3,330,000
Central and West Africa Regional	114,452,000
East Africa Regional	33,332,000
Southern Africa Regional	90,929,000
Africa Regional	466,711,000
West Berlin	131,881,000
European Regional	622,976,000
Pacific Islands (Trust Territories of the United States)	834,151,000
Oceana Regional	40,158,000
Interregional	29,830,000
Total U.S. foreign aid for the period 1946 through 1980	229,105,000,000
Total other U.S. loans and grants for the period 1940 through 1980	47,476,000,000
Total foreign aid for fiscal year 1981 (estimate)	9,886,000,000
Grand total	286,467,000,000

Mr. HELMS. Mr. President, $286 billion—what a massive sum. The total budget of the U.S. Government in 1974 was $267.9 billion.

Mr. President, I now offer a table showing how much money, on an annual basis, the U.S. Government has provided for all forms of foreign assistance—including foreign economic assistance, foreign military aid, and other forms of grants and loans. This information was supplied by the Library of Congress, which obtained it from the annual appropriations bills passed by Congress, and I ask unanimous consent that it be printed in the Record at this point.

There being no objection, the material was ordered to be printed in the Record, as follows:

U.S. FOREIGN ASSISTANCE—1946–80

[In millions of dollars]

	Military/economic assistance	Multilateral development banks[1]	Export-Import Bank loans	Total
1946	2,092.0	3,504.3	1,712.3	7,308.6
1947	6,326.9	141.9	214.1	6,682.9
1948	2,961.0	127.0	78.9	3,166.9
1949	8,037.0	170.6	148.6	8,356.2
1950	4,775.2	70.4	330.1	5,175.7
1951	4,181.9	30.8	142.6	4,355.3
1952	4,009.3		110.6	4,119.9
1953	6,394.8		382.8	6,777.6
1954	5,814.1		35.8	5,849.9
1955	4,833.7		354.9	5,188.6
1956	5,407.9		192.1	5,600.0
1957	4,996.7	16.2	488.0	5,500.9
1958	4,669.9		540.3	5,210.2
1959	4,975.3	1,375.0	660.8	7,011.1
1960	4,833.0	80.0	305.0	5,218.0
1961	4,814.0	74.0	962.0	5,850.0
1962	6,862.0	172.0	277.0	7,311.0
1963	7,238.0	122.0	280.0	7,640.0
1964	5,109.0	112.0	352.0	5,573.0
1965	4,996.0	312.0	356.0	5,664.0
1966	6,901.0	364.0	359.0	7,624.0
1967	6,752.0	374.0	1,317.0	8,443.0
1968	6,898.0	424.0	743.0	8,065.0
1969	6,256.0	483.0	679.0	7,418.0
1970	6,307.0	480.0	1,379.0	8,166.0
1971	7,898.0	180.0	1,438.0	9,516.0
1972	9,101.0	142.0	2,237.0	11,480.0
1973	9,100.0	775.0	2,381.0	12,256.0
1974	8,164.0	814.0	3,831.0	12,809.0
1975	6,454.0	784.0	2,569.0	9,807.0
1976	6,582.0	24.0	2,218.0	8,824.0
1977	6,853.0	931.0	719.0	8,503.0
1978	7,910.0	1,104.0	2,867.0	11,881.0
1979	12,213.0	1,632.0	3,688.0	17,533.0
1980	8,217.0	1,478.0	3,236.0	12,931.0

[1] Data excludes callable capital.

Mr. HELMS. Mr. President, I then asked the Library of Congress to specify the interest rate at which the Federal Government borrowed money during each year from 1946 through 1980. I ask unanimous consent that the Record include that information at this point. This information, I stress, was provided by the Library of Congress as obtained from Historical Statistics of the United States and the Statistical Index to the Annual Report of the Secretary of Treasury.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

Year	Total U.S. foreign aid appropriated that year[1]	Interest rate at which U.S. Government borrowed money in that year (percent)[2]
1946	$7,308,600,000	1.996
1947	6,682,900,000	2.107
1948	3,166,900,000	2.182
1949	8,356,200,000	2.236
1950	5,175,700,000	2.209
1951	4,355,300,000	2.270
1952	4,119,900,000	2.329
1953	6,777,600,000	2.438
1954	5,849,900,000	2.342
1955	5,188,600,000	2.351
1956	5,600,000,000	2.576
1957	5,500,000,000	2.730
1958	5,210,000,000	2.638
1959	7,011,100,000	2.867
1960	5,218,000,000	3.297
1961	5,850,000,000	3.077
1962	7,311,000,000	3.279
1963	7,640,000,000	3.360
1964	5,573,000,000	3.560
1965	5,664,000,000	3.678
1966	7,624,000,000	3.988
1967	8,443,000,000	4.220
1968	8,065,000,000	4.449
1969	7,418,000,000	4.861
1970	8,166,000,000	5.559
1971	9,516,000,000	5.141
1972	11,480,000,000	5.093
1973	12,256,000,000	5.873
1974	12,809,000,000	6.560
1975	9,807,000,000	6.352
1976	8,824,000,000	6.457
1977	8,503,000,000	6.424
1978	11,881,000,000	7.126
1979	17,533,000,000	8.057
1980	12,931,000,000	9.032

[1] Statistical information provided by the Library of Congress Congressional Research Service, and based on U.S. Government documents, including Agency for International Development Statistics and Reports Division reports.

[2] Interest figures from Historical Statistics of the United States and Statistical Index to the Annual Report of the Secretary of the Treasury.

Mr. HELMS. Mr. President, I then sought to ascertain the effect of such a large annual expenditure of Federal funds over a period of 35 years—in other words, its effect on the national debt. I sought to determine, as precisely as possible, the effect of spending more than $286 billion in foreign aid.

At this point, I asked the Library of Congress to develop a set of assumptions so that the cost of foreign aid—in terms of 1982 dollars—and its effect on the Federal debt could be reasonably assessed.

Mr. President, here are the assumptions that the Library of Congress took into account in complying with my request:

First, my request was for a tabulation of the interest payments and outstanding debt obligations associated with a series of expenditures. The annual expenditures and interest rates are based on information contained in the preceeding tables, which were prepared with the assistance of the Agency for International Development, the Appropriations Committee of the U.S. Senate, and the Library of Congress.

Second, to calculate the interest payments, the Library of Congress assumed that the U.S. Government issued bonds of 3 year term to finance the full amount of the stated expenditure in each year.

Third, thus, the total amount of interest associated with a given bond issue equals the face value of the bonds, multiplied by the interest rate of the bond, and compounded to the present date.

Fourth, The Library assumed that the interest payments were also financed by borrowing.

Fifth, it was also assumed, at my suggestion, that all bonds were rolled over at maturity into new debt obligations. Thus, for example, in 1946, 7.3 billion dollars' worth of 3-year bonds are assumed to have been issued at an interest rate of 1.996 percent. Since bonds would have matured in 1949, it was further assumed that they would be paid off by issuing 7.3 billion dollars' worth of new bonds at the 1949 interest rate of 2.236 percent. Thus, together with bonds to finance the 1949 expenditures of $8.3 billion and bonds to finance the payments due in 1949, the total amounts of new bonds issued in 1949 would be $16 billion.

It was on this basis, and at my suggestion, Mr. President, that the Library of Congress proceeded to make its calculations. In a moment I will offer for the RECORD a table disclosing this information, but first, Mr. President, perhaps an explanation of the table would be in order.

Column 1 of the table shows the current expenditure in each year.

Column 2 shows the rolled-over debt obligation.

Column 3 identifies the amount of interest due in a given year.

Column 4 discloses the total amount of bonds issued each year.

Column 5 contains the interest rate applicable each year, based on the rate at which the U.S. Government borrowed money during that year.

Finally, the total amount of outstanding bonds insuing from these expenditures is contained in column 6.

Mr. President, I emphasize that I requested that the Library of Congress assume, in its calculations, that the expenditures made in a given year were financed exclusively by borrowing—and that, had those expenditures not been made, the Federal Government would have borrowed that much less.

The hypothetical assumption was made that there would have been no changes in spending on other Federal programs, or in tax rates; and that in the very few years when the deficit was less than the Federal Government's expenditures on foreign aid, none of the relatively small savings made would have been used to retire the national debt.

Mr. President, I ask unanimous consent that these computations by the Library of Congress be printed in the RECORD at this point.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

INTEREST AND PRINCIPLE ASSOCIATED WITH DEBT FINANCING A SERIES OF EXPENDITURES [Dollar amounts in millions]

Year	Current expenditures	Rolled-over debt obligation	Interest payment due on outstanding bonds	Total bonds issued	Interest rate (percent)	Total outstanding bonds
1946	$7,308.6	0.0	0.0	7,308.6	1.996	7,308.6
1947	6,682.9	0.0	$145.9	6,828.8	2.107	14,137.4
1948	3,166.9	0.0	289.8	3,456.7	2.182	17,594.0
1949	8,356.2	$7,308.6	365.2	16,030.0	2.236	33,624.0

INTEREST AND PRINCIPLE ASSOCIATED WITH DEBT FINANCING A SERIES OF EXPENDITURES—[Dollar amounts in millions]—Continued

Year	Current expenditures	Rolled-over debt obligation	Interest payment due on outstanding bonds	Total bonds issued	Interest rate (percent)	Total outstanding bonds
1950	5,175.7	6,828.8	577.7	12,582.2	2.000	46,229.2
1951	4,365.3	3,436.7	695.5	8,497.5	2.270	54,703.7
1952	4,199.9	16,030.0	803.0	21,032.9	2.325	75,736.6
1953	6,777.6	12,582.2	934.4	20,294.2	2.438	96,030.8
1954	5,849.9	8,497.5	1,177.5	15,524.9	2.340	111,556.7
1955	5,188.6	21,032.9	1,347.9	27,569.4	2.358	139,125.0
1956	5,608.0	20,294.2	1,506.2	27,408.4	2.576	166,525.4
1957	5,500.0	15,524.9	1,717.3	22,742.2	2.730	189,267.6
1958	6,270.0	27,569.4	1,971.9	30,794.2	2.620	224,823.8
1959	7,811.3	27,408.6	2,243.5	36,656.0	2.867	258,674.8
1960	3,718.0	22,742.2	2,508.6	30,548.7	3.297	271,223.0
1961	5,888.8	30,794.2	2,974.9	43,579.1	3.072	324,806.7
1962	7,201.0	36,656.0	3,700.3	47,382.9	3.220	382,357.6
1963	7,540.0	30,548.7	3,880.0	42,968.7	3.380	424,236.3
1964	5,973.0	43,579.1	4,295.3	53,438.5	3.560	477,674.8
1965	5,860.0	47,382.9	4,850.8	57,989.9	3.670	526,556.7
1966	7,334.0	42,968.7	5,444.8	55,147.5	3.980	580,368.2
1967	8,453.0	53,438.5	6,230.6	68,112.0	4.039	638,655.2
1968	8,064.0	57,989.9	7,079.2	73,025.1	4.440	711,080.3
1969	7,814.0	55,147.5	8,259.7	71,180.7	4.851	802,001.0
1970	8,168.0	68,112.0	9,482.4	85,758.4	5.567	886,758.1
1971	9,326.0	73,025.1	11,096.0	94,036.0	6.141	982,765.5
1972	11,465.0	71,180.7	13,000.5	95,721.2	5.960	1,074,516.7
1973	12,756.0	85,758.4	14,475.1	112,489.5	5.872	1,181,066.2
1974	12,888.0	94,036.0	16,914.8	123,158.5	6.960	1,314,106.0
1975	9,887.0	95,721.2	19,564.8	125,988.0	6.352	1,436,754.8
1976	8,524.0	112,489.5	22,630.3	143,941.7	6.457	1,543,197.7
1977	8,500.0	123,158.5	25,159.3	156,982.2	6.426	1,708,179.9
1978	11,811.0	125,988.0	27,324.5	164,293.5	7.126	1,804,473.5
1979	17,533.0	143,941.7	31,066.5	192,563.3	8.257	2,007,836.7
1980	12,871.0	156,982.2	37,308.9	207,238.1	9.812	2,304,257.9

Mr. HELMS. Mr. President, when I first examined these figures, I was dumb-founded. But the Library's computations are correct, based on the assumptions that the Library made, and predicated upon my specific request.

So, Mr. President, to reiterate, the Library of Congress has computed that the net cost of foreign aid, in 1982 dollars, has been $2,304,257,900,000.00, more than twice the existing national debt of the United States, and just short of the latest estimates of our Nation's gross national product for the year.

This is an astounding figure.

There may be some, Mr. President, who will choose to find fault with this computation. I do not believe their complaints, if any, will be valid. But if it will comfort them I am willing to halve the total figure, if it will satisfy their concerns.

It is true that some countries have repaid a portion of their debt to the United States over the years—something like $30 billion has been repaid since 1946. So, we should allow for that, of course. In addition, no one knows what effect on taxes, or on other Federal programs, might have derived from a budget with no foreign aid expenditures. That would be sheer speculation. Would there be a decline in tax revenues or lower taxes as a result of cutting foreign aid? What effect would cuts in foreign aid have had on Government borrowing?

It is, however, fair to say that the funds spent on foreign aid, had they been spent in the United States, would have resulted in a far higher gross national product today for the United States. A higher GNP would have meant higher revenues with the same tax rates we have today and thus a smaller deficit and fewer of the problems that are crippling our economy. It is, however, impossible to predict with certainty the effects of reallocated resources, but I think it is fair to say that the return on an investment anywhere in the United States would have been better than in the "investments" we have made with our foreign aid program.

But, Mr. President, what I do know—and every other American knows it—is this: The American people are being stifled by a huge Federal deficit, high interest rates, and a national debt of more than a trillion dollars.

No longer is there confidencee in the stock market as a place for long-term investment. In 1966, the stock market peaked at 1,000 and has not seen that level since. Today the market fluctuates in the 800's. But in terms of 1982 dollars, a 1,000 Dow Jones 1966 average would equal about 3,000 today.

In the 1970's people moved from stocks into tangible commodities as a safe haven for investment as public confidence in financial markets waned. Thus, real estate, gold, antiques, and other tangible collectibles became the focus of much public investment.

Today, gold prices have fallen from a high of more than $800 to the low $300's. High interest rates have all but destroyed investment in real estate. Tangibles have gone the way of stocks as stable forms of investment.

The long-term bond market today is minimal. Industry is financing capital expenditures, to the extent they exist, from the short-term market.

The American people are today investing mostly in money market funds, an asset which is more liquid than most others, and more accessible to the investor. Put another way, the store of value that is most attractive today is the one with the shortest future.

What has happened to erode public confidence in the future of our Nation's economy? Why do most citizens feel comfortable in investing only in short-term money market funds?

I submit that the incredible Federal debt is one of the most important reasons for this Nation's economic woes.

That exact Federal debt on May 11 was $1,060,237,928,516.01.

That is one trillion, sixty billion, two hundred thirty seven million, nine hundred twenty eight thousand, five hundred sixteen dollars and one cent.

Thus, the national debt is one-third of the gross national product of the United States; in the first quarter of 1982, the GNP of the United States, annualized by the Treasury, was $2.995 trillion.

Mr. President, this fiscal year, it will require more than $115 billion just to pay the interest on the Federal debt. This is a figure which exceeds the entire budget of the United States just 20 years ago; $115 billion is more than three times the budget outlays for defense of Great Britain, our NATO ally. Is there any wonder that the economy is in turmoil?

Without the burden of such interest payments, not only could the President balance the current Federal budget—there would be a surplus to return to the taxpayers.

How did we get into such a state?

Congress after Congress voted irresponsibly to approve grotesque deficits. President after President, of both parties, proposed such budgets, and Congress went along.

Programs having no place in the Federal budget were proposed and became law: Food stamps, a variety of ill-conceived transfer payment programs, and many others. Among the most costly of those has been foreign aid.

Mr. President, have we learned a lesson?

The blame for all this is bipartisan. It has been a bipartisan folly which many Americans condoned through apathy or disinterest. But now that bedraggled economic chickens have come home to roost, perhaps we can now stand united for commonsense—and with an understanding of the tragic arithmetic of the long-accepted myth of "free money from Washington."

The cost of past foreign aid programs cannot be recovered. The expenditures made have been made and we can learn from that loss.

We should ask ourselves: What will the next 35 years hold? Will some Senator in the year 2000 have the Library of Congress compile figures to assess the real cost of foreign aid in the years 1982-99? Will that Senator have to point to more hundreds of billions of dollars of lost resources? Of lost opportunities? Of lost taxpayers earnings?

That is a judgment that must be made now—by those of us now serving in the Congress of the United States.

PRIVILEGE OF THE FLOOR

Mr. STAFFORD. Mr. President, I ask unanimous consent that Polly Gault and David Morse, of the staff of the Education Subcommittee, have the privilege of the floor during the consideration of Senate Concurrent Resolution 92 and votes thereon.

The PRESIDING OFFICER (Mr. COCHRAN). Without objection, it is so ordered.

Mr. BAKER. Mr. President, I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk proceeded to call the roll.

Mr. BAKER. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

ORDER OF BUSINESS

Mr. BAKER. Mr. President, I might explain for those Senators who may be listening in their offices or elsewhere and for any who are in the Chamber that in a moment I shall ask unanimous consent that the Senate stand in recess until 5 p.m.

I have conferred with the distinguished minority leader, and he indicates that he will have no objection to that.

Mr. President, the reason for it, for the information of Senators, is that meetings will be held on this side of the aisle off the floor. I believe those meetings will contribute to an orderly disposition of this matter and perhaps even expedite its final disposition.

RECESS UNTIL 5 P.M.

Mr. BAKER. Mr. President, I ask unanimous consent that the Senate now stand in recess until the hour of 5 p.m. today.

There being no objection, the Senate, at 3:11 p.m., recessed until 5 p.m.; whereupon, the Senate reassembled when called to order by the Presiding Officer (Mr. EAST).

ORDER OF PROCEDURE

Mr. STEVENS. Mr. President, I suggest the absence of a quorum.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk proceeded to call the roll.

Mr. KENNEDY. Mr. President, will the Senator withhold that request, so that we may have a chance to call up an amendment to restore the $40 billion which has been cut from social security?

Mr. STEVENS. Mr. President, I suggest the absence of a quorum.

Mr. KENNEDY. There are a number of us who have been here for the past 2 days waiting to offer this amendment.

The PRESIDING OFFICER. The clerk will call the roll.

The legislative clerk continued the call of the roll.

Mr. HOLLINGS. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

Mr. STEVENS. I object.

The PRESIDING OFFICER. There is objection.

The legislative clerk continued the call of the roll.

Mr. BAKER. Mr. President, I ask unanimous consent that the order for the quorum call be rescinded.

The PRESIDING OFFICER. Without objection, it is so ordered.

REQUEST FOR PERIOD FOR TRANSACTION OF ROUTINE MORNING BUSINESS

Mr. BAKER. Mr. President, I ask unanimous consent that there now be a brief period for the transaction of routine morning business to extend not past the hour of 6 p.m. in which Senators may speak for not more than 3 minutes each.

THE BUDGET RESOLUTION

Mr. ROBERT C. BYRD. Mr. President, reserving the right to object, I inquire of the distinguished majority leader whether or not this means the Senate will not go back on the budget resolution today?

Mr. BAKER. Yes, Mr. President, it does. It means that, at some point after we have transacted certain routine matters, assuming that we do go into a period for the transaction of routine morning business, I will ask that the Senate stand in recess until an early hour in the morning. I would anticipate that the Senate will resume consideration of Senate Resolution 92 at approximately 9 o'clock in the morning.

Mr. KENNEDY addressed the Chair.

Mr. ROBERT C. BYRD. Mr. President, reserving the right to object. As I have indicated to the distinguished majority leader in our private conversations, Senators on this side of the aisle have been ready and available and waiting to call up amendments to the budget resolution. They have been prevented from calling up these amendments by virtue of the recesses that have been accumulating during the afternoon. Of course, there is no way that we can keep the recesses from taking place, because if the distinguished Senator from Tennessee gets an objection to his request to recess and finds it necessary to move to recess, that motion is not debatable and all he needs is the votes to deliver a majority vote. So this side of the aisle is rather helpless in preventing recesses.

I must say that Senators on this side do want to offer amendments. I would have to object to the request to go into morning business, hoping that we could get some consideration whereby we could call up some amendments. I realize that the distinguished majority leader can still put us into recess overnight, but we do have some amendments that we would like to call up. Naturally we would like to call up some on social security. But even if we had to have the understanding that we could call up some other amendments, we have other amendments we would like to call up, and we would like not to be prevented from doing so by recessing.

I understand the majority leader's situation. I understand he has had to have time to have discussions with his Members on his side. But my Senators have been waiting. The ranking member on the Budget Committee, Mr. HOLLINGS, has been waiting all afternoon. Mr. KENNEDY has been waiting to call up his amendment, and other Senators have been waiting. So I think I would have to be constrained to object to this request.

Mr. BAKER. Mr. President, before the Senator does object, may I say that I fully understand the position stated by the minority leader.

I can report, as he has indicated, that he and I have had private conversations on this matter during the course of this day on more than one occasion. I may also say for the record that the minority leader has been very insistent that we get on with the business at hand and has advised me that a number of Senators on his side of the aisle have amendments and they are anxious to get to them.

I must say, very frankly, that I have declined to agree that that would occur and, indeed, have asked the Senate to stand in recess for a good part of this day. I would point out that those recesses, except for the period from 12 to 2 when both parties were in caucuses, have not been charged against the time remaining under the statute for debate on this resolution. So no one has lost that time for debate nor has any Senator lost the opportunity to offer amendments.

It is entirely probable that the chairman of the Budget Committee will have a further statement to make on

EXHIBIT NO. 14

ISSUE:

50/50 Corporations

FACTS: Taxpayer is in the business of manufacturing products from steel wire. Taxpayer formed a Bahamian corporation that is 50% owned by the U.S. principal shareholder of Corporation A, and 50% owned by a Swiss holding company, which is owned by German nationals. The taxpayer imports the wire from Japan through a U.S. port of entry. The orders are placed by the Bahamian corporation, but paid by a bankdraft of corporation A. Goods come in to the U.S. at the bankdraft price for Customs duty purposes; then the Bahamian company bills the U.S. company 10 to 20 percent over the bankdraft or custom's price. The Bahamian company lends money to the U.S. shareholders of corporation A. The U.S. company repays the loan; however, it is interest free.

PROBLEM:

The 50/50 ownership circumvents Subpart F and the tax haven secrecy laws prevent knowing the operations of the Bahamian corporation.

ISSUE:

Captive Offshore Insurance Companies.

FACTS: Taxpayers under U.S. laws are not permitted to establish a reserve for self-insurance. Many taxpayers, because of their business activity, must either pay high premiums or cannot obtain insurance. Other taxpayers feel that it is good business practice to be a self-insurer. These companies have been establishing offshore insurance companies in tax haven countries, such as Bermuda or the Cayman Islands. In some cases the taxpayers will pay a premium to an unrelated insurance company with a prearrangement that the company will reinsure with the offshore insurance company. The Service has issued a Revenue Ruling, and successfully won a Supreme Court case on this issue.

PROBLEM:

In spite of the Revenue Ruling and the court case, these offshore insurance cases continue to grow.

ISSUE:

Tax Haven Bank Accounts.

FACTS: The taxpayer exported building products to foreign countries. The taxpayer was paid for shipment of goods to various foreign countries by irrevocable letters of credit at large U.S. banks with international banking departments. The banks made disbursements of funds received on the irrevocable letters of credit according to taxpayer's instructions. The bank would pay suppliers, freight, make a payment to the account at the Bank of Nova Scotia, Cayman Islands, and the balance would be deposited in taxpayer's (100% shareholder) domestic checking account. It was determined that the account at the Bank of Nova Scotia, Cayman Islands, belonged to a shell corporation, belonging to the sole shareholder of the U.S. corporation. This money should have been reported as income by the U.S. corporation.

PROBLEM:

Bank secrecy laws in tax haven countries inhibit the ability to track the flow of cash and other transactions.

ISSUE:

Avoidance of Subpart F Income by Forming a 50/50 Corporation.

FACTS: In the year 1981, Corporation A was owned 100% by a United States person. Corporation A was engaged in the manufacture and sale of products to Japan. All income is reported for U.S. income tax purposes. In the year 1982, the U.S. person acquires a 50% interest in a Cayman Island corporation. The remaining 50% are owned by a Japanese national. The product manufactured in the United States is now invoiced through the Cayman Island's corporation at a lower price than previously sold to Japan.

PROBLEM:

Because of the Cayman Island's law, little is known of the offshore corporation's activity or the function the 50% Japanese owner of the corporation plays. Because the corporation is owned 50% by a non-U.S. person, it is not a controlled foreign corporation subject to Subpart F. In this situation the taxpayer has avoided U.S. taxes by forming an offshore corporation which is not controlled more than 50% by U.S. persons.

ISSUE:
Illegal Rebates Through Tax Haven.

FACTS: A United States travel agent requested several foreign airlines to deposit unreported illegal rebates directly to his account in Switzerland. At least $1,250,000 were transferred by wire from the European bank accounts of the foreign airlines to the travel agent's Swiss account. The agent did not bring any funds back into the U.S.; however, large sums were spent abroad on villas, vacations, etc.

PROBLEM:
Bank secrecy laws of foreign tax havens.

ISSUE:
Service Company Performing Services Outside Country of Incorporation.

FACTS: The U.S. taxpayer is an architectural and engineering firm. They formed a subsidiary in Switzerland for the purpose of working Middle East contracts. The U.S. taxpayer enters into contracts for jobs overseas; however, all substantive work is performed in the United States. The U.S. company furnishes on-site workers who are employees of the U.S. company; however, the Swiss subsidiary bills the U.S. taxpayer for the on-site labor. Ostensibly, the Swiss sub. is claiming that they control the performance of the employees which performed overseas.

PROBLEM:
Subpart F income does not include the foreign base service income of branch operations.

ISSUE:

Multiple Use of Tax Havens by Multinational Corporations.

FACTS: Taxpayer is a large multinational corporation that uses many tax havens. Taxpayer has a wholly owned CFC in Switzerland that is used to collect royalty income from licenses and patents. The patents were transferred to the Swiss company in the 1960's. The taxpayer has a wholly owned subsidiary based in the Netherlands and the Netherland Antilles, which are finance companies, to sell on the Eurobond market. The taxpayer also has a captive insurance company in Bermuda.

PROBLEM:

This demonstrates that multinational corporations make extensive use of tax havens and thus can divert otherwise taxable income to other nontax countries.

ISSUE:

Limitation on Foreign Tax Credit.

FACTS: Many taxpayers operating in high tax countries and tax havens accumulate excess foreign tax credits. These same companies are earning profits in tax haven countries where no taxes are paid. The companies can report the earnings in the tax havens as U.S. income, but at the same time have it offset by an excess foreign tax credit paid to another country.

PROBLEM:

U.S. taxpayers are obtaining the benefit of the foreign tax credit to offset income earned in a nontax country

ISSUE:

Formation of Tax Shelter in Tax Haven Country.

FACTS: A Bermuda corporation purchased a building in the United States for $7.5 million. This was determined to be an arm's-length price between unrelated parties. On the same day this building was sold to a partnership in the Bahamas for $10 million. The relationship between these parties is unknown, as the sale took place in countries with secrecy laws.

PROBLEM:

The inflated basis can be used to claim excessive depreciation by the U.S. partners.

LEADING CASES RELATING TO SECTION 482 I.R.C.

E. I. Dupont de Nemours & Co. v. U.S., 608 F.2d 445 (Ct. Cl. 1979), cert. denied, 445 U.S. 962 (1980)

Eli Lilly & Co. v. U.S., 178 Ct. Cl. 666, 372 F.2d 990 (1967)

Commissioner v. First Security Bank, 405 U.S. 394 (1972)

Huber Homes, Inc. v. Commissioner, 55 T.C. 598 (1971)

Pauline W. Ach, 42 T.C. 114, affirmed 358 F.2d 342 (C.A. 6), cert denied 385 U.S. 899

Latham Park Manor, Inc., 69 T.C. 199 (1977)

B. Forman Co. v. Commissioner, 453 F.2d 1144 (2d Cir) cert. denied 407 U.S. 934 (1972)

Rubin v. Commissioner, 56 T.C. 1155, affirmed per curiam, 460 F.2d 1216 (2d Cir. 1972)

National Securities Corp. v. Commissioner, 137 F.2d 600 (3d Cir. 1943), cert. denied 320 U.S. 794 (1943)

W. Braun Co. v. Commissioner, 396 F.2d 264 (2d Cir. 1968)

Hamburgers York Road, Inc. v. Commissioner, 41 T.C. 821 (1964)

Elko Realty Co. v. Commissioner, 29 T.C. 1012 (1958), affirmed per curiam, 260 F.2d 949 (3d Cir. 1958)

Covil Insulation Co. v. Commissioner, 65 T.C. 364 (1975)

Textron, Inc. v. U.S., 561 F.2d 1023 (1st Cir. 1977)

Lucas v. Earl, 281 U.S. 111 (1930)

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EXHIBIT NO. 15

INCORPORATING IN PANAMA

Incorporating a Panamanian company is accomplished quickly and easily through INTERSECO. Information required for registration is simple and the purposes of the company may be described in very broad terms.

Fees and taxes associated with registering a Panamanian company, particularly one intended to operate outside Panama, are nominal. The minimal information required to register a Panamanian company is:

1. Name of the corporation, which can be in any language and which must include one of the following words or abbreviations: Corporation (Corp.), Incorporated (Inc.) or Sociedad Anónima (S.A.).
2. Specific objects and powers of the company; these may be described in broad general terms, plus the usual escape clause "any other legitimate business".
3. Amount of authorized capital. Usually we suggest to our clients an authorized capital of US$10,000.00 or 500 shares of no par value stock, since a lower capital will still bear the same minimal capital stock tax.
4. Type of shares (nominative and/or bearer, common and/or preferred) and class of shares (Class A or Class B, voting or non-voting).
5. Three full names (no abbreviations are allowed even for middle names) and full addresses of the persons acting as directors of the proposed company, since the Panama Corporation Law requires a minimum

of three (3) directors. These three directors may also act as officers, namely President, Secretary and Treasurer. Additional officers may be appointed, if desired, and one person may hold two positions, except that the President cannot be the Secretary at the same time. However, one person may be a director and not an officer and viceversa. Directors need not be shareholders and they may be non-resident aliens.

6. Duration, commonly shown as in perpetuity; however a company may be dissolved at any time.

If, for some reason, clients do not wish to act as directors and officers of the proposed Panama company, our bonded employees can act in such capacity on the clients' behalf. In such cases, we require a "hold harmless" agreement under which clients hold us harmless for acting on their behalf.

The cost of incorporating and registering a Panama company includes US$ [illegible] for legal fees and about US$ [illegible] for expenses (depending on the length of the corporate charter and the amount of authorized capital).

The Government of Panama levies a nominal capital stock tax upon registration of the company (or, proportionally, on any increase in authorized capital) computed on the following scale:

US$ 20.00 (minimum tax) on the first	US$	10.000.00
US$ 0.75 per US$1,000.00 on the next	US$	90.000.00
US$ 0.50 per US$1,000.00 on the next	US$	900.000.00
US$ 0.10 per US$1,000.00 in excess of	US$	1,000.000.00

All public deeds are subject to a 20 % surtax on Public Registry fees.

An annual Maintenance Tax of US$100.00 per company is charged by the Government and is payable within three months of registration and annually on the anniversary date of registration. A surcharge of US$20.00 is made for late payment.

Once the company is formed, other than the Annual Maintenance Tax the only annual fees to be paid would be US$150.00 per year for the attorneys for acting as Statutory Resident Agent, a requirement of Panamanian Law.

Should we be required to act as directors and officers for the company, our annual directors/officers fees are US$200.00 per person.

INTERSECO needs the following before it can proceed with forming a Panama company:

1. The proposed name of the company (several choices in order of preference, because of the larger number of companies already registered).
2. The amount of the desired capital stock.
3. At least three full names and addresses of the proposed directors and officers or an indication that our bonded employees should act in this capacity.
4. A check for US$500.00 as advance payment for the incorporation of the company.

NOTE: Interseco is not a firm of attorneys or CPAs. It uses, however, the services of competent professionals.

Companies

The minimum requirement for incorporating a Cayman company is the filing of the Memorandum and Articles of Association with the Registrar of Companies and the payment of the relevant Government fees. The Memorandum and Articles of Association must be subscribed to by at least three members. The Memorandum and Articles contain the name of the Company, its objects and powers, the address of the registered office and the amount, type, number and par value of the authorised share capital and a statement of the limitation of shareholders liability. The Articles are the equivalent of the Bye-Laws in a United States company and include provisions for regulating the company's own affairs.

The company may commence business upon the issuance of the Certificate of Incorporation. The company, as under English Law, has a separate legal identity, perpetual succession and a common seal. Butterfield's Bank & Trust Company Limited can proceed with the incorporation of a company upon receipt of the initial deposit required to pay legal fees, Government incorporation costs, out-of-pocket expenses and the Butterfield's Bank & Trust minimum fee for the first year's operations.

The TWO main types of companies that can be formed under the Cayman Islands Companies Law are:

ONE:

Ordinary Companies

An Ordinary Company must have three shareholders and must hold a general meeting at least once a year. The Company is also required to file an annual return giving details of shareholders, directors and capital structure. The following are the details of the fees payable to Government with relationship to ordinary companies:

Government Registration Fees:
(Payable on filing of Memorandum of Association)
1/20th of 1% of the authorised capital,
minimum CI.$400; maximum CI.$1,200

Annual Fee: (Payable upon filing of Annual Return)
1/40th of 1% of the authorised capital,
minimum CI.$200; maximum CI.$600

TWO:

Exempted Companies

If a Cayman company transacts business outside the Island and files a statement to that effect with the government upon incorporation, it may be set up as an exempted company. It would have the same legal requirements as an ordinary company except for the following:

1 A meeting should be held at least once a year in the Cayman Islands and two directors must be present, either in person or by proxy.
2 No general meeting need be held but this is subject to the provisions of the Articles of Association.
3 The name of the company does not have to have the word "Limited" or "Ltd" in its name and the name may be in a foreign language in addition to English.
4 The company may issue shares of "no par value".
5 Bearer shares may be issued or registered shares converted into bearer form, provided they are fully paid and non assessable.
6 An exempted company will receive an undertaking from the Governor in Council to exempt it from future taxes for a specified period, usually twenty years.
7 No annual return of shareholders need be filed with the Registrar of Companies. Instead, the directors have to provide the Registrar with a declaration that the provisions of the Companies Law have been complied with. This is a standard Government form and should be filed in January every year along with the Annual Government fee. The following are the fees payable to the Government with relationship to exempted companies:

Government Registration Fees:
(Payable on filing of Memorandum of Association)
1/10th of 1% of the authorised capital,
minimum CI.$750; maximum CI.$1,800
Annual Fee: (Payable on filing of Annual Return)
1/20th of 1% on registered capital,
minimum CI.$375; maximum CI.$1,200

Investment Companies

Because of the freedom from exchange control and tax free status of the Cayman Islands, investment holding companies are able to diversify their investments world wide. They can take advantage of markets where there are no capital gains taxes or withholding taxes assessed on foreign investments and all income and gains remitted to the Cayman Islands are tax free.

Butterfield's Bank & Trust Company Limited has access to most of the major stockbrokers and International Banks and the following are the advantages of using our services:

1 The funds will be managed in the Cayman Islands and in certain jurisdictions will be treated favourably from a taxation standpoint.

2 The securities will be held in the name of Butterfield's Bank & Trust or its nominee, hence the name of the beneficial owner will not be disclosed when purchases and sales are made.

3 The investments will be reviewed on a regular basis by Butterfield's Bank & Trust and a stockbroker. The choice of broker will be at the discretion of the beneficial owner. The client will usually decide what type of investments he requires in his portfolio and Butterfield's Bank & Trust Company will act accordingly.

4 A full accounting will be made to the client of all transactions during a period.

5 Dividends will be paid to Butterfield's Bank & Trust or its nominee as the registered holder of the securities and they will be responsible for ensuring dividends have been received.

Trading Companies

The use of an offshore Trading Company has virtually no limitation and can participate in a wide range of commercial enterprises. It can be used to control International purchasing of raw materials, manufactured goods or entering into management agreements for professional or consulting services. The profits from such ventures can be retained in the Cayman Islands for further investment.

General

Before any decision is taken as to the formation of a Cayman company we suggest professional advice be obtained from tax and legal counsel. To ensure the effective use of a Cayman Islands Company it is necessary to demonstrate mind and management of the Company is conducted by a resident of these Islands. Butterfield's Bank & Trust is prepared to act, where it thinks appropriate, and provide the following services for Cayman Corporations:

1 To arrange the Incorporation.
2 To provide a Registered Office.
3 To act as Directors and Corporate Secretaries.
4 To act as nominee Shareholders.
5 To provide full Accounting, Management and Clerical Services.
6 To provide Investment Services.

The fees charged for such services can be found in our Schedule of Fees Booklet.

Trusts

Cayman Trusts are established under the principles of English Law as supplemented by local legislation, tailored to meet the requirements of a tax free financial centre. The establishment of a Trust in these Islands is governed by the Trust Law of 1967.

The distributive powers of a Trust Deed may be specific as in the case of a strict settlement, but a more common form is the Discretionary Trust which, in essence, gives the Trustees complete discretion in the choice of beneficiaries within a named class or classes. This is often used as an estate planning device where the avoidance of inheritance tax and death duties is important.

In many jurisdictions it is also possible to limit or avoid the impact of taxation. However, to benefit from this it is necessary that control and management of the Trust funds be vested with a Trustee who is resident in the Cayman Islands. In most jurisdictions the Trust will then be treated as a Caymanian Trust and the Trustee will enjoy the advantages of non-residents when investing trust assets. Resulting income can then be accumulated, without local tax, until such time as the Trustee, in his discretion, decides to distribute to the beneficiaries.

It should be noted however, that many jurisdictions have enacted laws to prevent individuals transferring their assets abroad or to tax the income arising therefrom, even if the said assets have been alienated from the control of the grantor. Again, we would emphasise the necessity for anyone settling funds into a Cayman Trust to first obtain proper legal and tax advice in his own country of residence so that he will be fully aware of the implications of any proposed actions.

The Cayman Trust Law also has provision for an exempted Trust, the beneficiaries of which must be non-residents of the Cayman Islands. Such a Trust must be discretionary and approved by the Registrar of Trusts and offers a guarantee of freedom from future Cayman tax for periods of up to fifty years. The exempted Trusts attract an annual Government fee payable in March of each year of CI.$100 or such lesser sum as the income of the Trust shall amount to in the previous calendar year. It should be noted that the Trustees of an exempted Trust can be required to furnish the Registrar of Trusts with accounts, minutes and information relating to the Trust as he may from time to time require and the original Trust Deed must be registered but is not a public document.

A Cayman Trust is often used to hold shares in a Cayman company. The income and gains of the Cayman company are free of tax and the beneficiaries of the Trust may avoid paying tax on the income and capital gains of the company. When it is wished to distribute the Trust, the company can be voluntarily liquidated and the assets distributed to the beneficiaries

Butterfield's Bank & Trust will accept the appointment of Trustee or Co-Trustee in approved cases and has available model trust deeds which conform to Cayman Law. However, the Trust Deed can be altered and tailored to a client's specific need but will be subject to our acceptance and reviewed by a local attorney to ensure compliance with Cayman Law.

The following are the costs involved:

1. Stamp Duty on Trust Deed
   (both Exempted and Ordinary Trust) CI.$40
2. Registration Fee payable on approval
   by Registrar of exempted status CI.$200
3. Attorney's fees between CI.$500 and
   (depending on work involved) CI.$1,000
4. Butterfield's Bank & Trust cost for administering Trusts can be found in the booklet entitled "Schedule of Fees".

Chairman ROTH. Thank you gentlemen, for your testimony.

At this time, I would like to call forward Raul Dearmas, special agent, IRS Criminal Investigation, assigned to "Operation Greenback." He will be accompanied by Richard Wassenaar, Assistant Commissioner of IRS. Gentlemen, would you please raise your right hand? Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. DEARMAS. I do.

Mr. WASSENAAR. I do.

Chairman ROTH. Please be seated. Gentlemen——

Mr. WEILAND. It is my understanding that, perhaps Mr. Wassenaar is going to introduce Mr. Dearmas and then proceed with some extemporaneous remarks. And then they will be open for questions.

TESTIMONY OF RAUL DEARMAS, SPECIAL AGENT, IRS CRIMINAL INVESTIGATION DIVISION, ASSIGNED TO "OPERATION GREENBACK"; AND RICHARD C. WASSENAAR, ASSISTANT COMMISSIONER FOR CRIMINAL ENFORCEMENT, INTERNAL REVENUE SERVICE

Mr. WASSENAAR. I do appreciate the opportunity, Mr. Chairman, of appearing before your subcommittee for the second time in as many days. Before I introduce the next witness, let me compliment the subcommittee staff for the thoroughness, the in-depth, professional manner in which they conducted their investigation. I think the fact that they went onsite, made a number of trips to where the action truly is, gave all of us a better understanding of the true nature and the true magnitude of the problem that both you and the subcommittee are addressing. My compliments.

Chairman ROTH. I appreciate very much, those remarks on behalf of the staff. It is very encouraging.

Mr. WASSENAAR. Mr. Chairman, I have with me, Mr. Raul Dearmas. Mr. Dearmas is a special agent in Criminal Investigation from IRS' Miami office. He has been a special agent criminal investigator for the past 10 years. He has been assigned to Operation Greenback since its inception.

Mr. Dearmas has no prepared statement, but he will be able to relate to you general information concerning the operations, the successes of the Operation Greenback and he will provide to you, more specific information concerning the Colombian money exchange houses in the Miami area.

Chairman ROTH. Thank you.

Mr. DEARMAS. Mr. Chairman, I am here to discuss one form of laundering which is the use of Colombian exchange houses in Miami. Colombians have been using exchange houses since the early forties. In 1967, the Government of Colombia tried to control the exchange houses. But it was not until the 1970's, based on the dramatic explosion of narcotics trafficking from Colombia to the United States that the exchange houses really took off.

The exchange houses exist only because there is an over-abundance of U.S. narco-dollars in the United States, which is owned by Colombian narcotics traffickers. One of the advantages the exchange houses offer is an immediate laundering of narco-dollars. I am going to give you a specific example.

A narco-dollar originates domestically in this country and then has to be used by the domestic narco-trafficker to pay his Colombian supplier. Let us assume that a Colombian supplier sends 1 million dollars' worth of narcotics to the United States. The narcotics is delivered to the domestic trafficker. Now the domestic narco-trafficker has to pay $1 million to the Colombian supplier. However, the moneys are in U.S. dollars. How does he get these dollars to the Colombian narco-traffickers?

For argument sake, the official rate of exchange is 60 pesos to one U.S. dollar. Because the narco-trafficker in Colombia wants to get Colombian pesos, he is willing to take less for his dollars in exchange for Colombian pesos. So he makes arrangements with the Colombian exchange house in this country to deliver to him $1 million in currency, let us say 45 Colombian pesos per dollar. In turn, upon receipt of that currency in this country, the Colombian exchange house will issue either a check or will institute a bank transfer in Colombia for 45 million pesos. That transaction is finished; $1 million from the narcotics proceeds has been laundered. The exchange house has $1 million sitting in Miami.

Chairman **Roth**. Could I ask one question there. Why would the person necessarily want pesos in Colombia?

Mr. **Dearmas**. Because he lives in Colombia and needs Colombian pesos.

Chairman **Roth**. Is there much fluctuation in the pesos in Colombia?

Mr. **Dearmas**. Yes. But the real need is that he needs Colombian pesos to keep on doing business. So at that point, that part of the exchange has been completed. The Colombian exchange house has $1 million in this country and has paid 45 million Colombian pesos in Colombia.

Now, enter a legitimate Colombian businessman who needs U.S. dollars in this country. Remember, the official rate of exchange is 60 pesos per dollar. The Colombian businessman contacts the Colombian exchange house and arranges to purchase $1 million for 55 million Colombian pesos. The Colombian businessman is then having 5 million Colombian pesos. In addition to that, because the Colombian businessman has access to black-market dollars, he is able to evade Colombian import duties, which is perhaps more important to him than the 5 million pesos savings that he realized in the exchange.

Chairman **Roth**. I am not sure I understand that. What was more important, some kind of a duty?

Mr. **Dearmas**. The savings in the Colombian import duty. Let me give you an example. If I bring a TV set into Colombia, I will have to pay approximately 200 percent import duty. If I buy $1 million worth of TV's in the United States, I would have to pay the equivalent to $2 million in import duty.

However, if I buy $1 million in TV sets in this country, my purchases, I invoice those TV sets for $100,000, I would be getting into Colombia, goods worth $1 million for which I will only pay $100,000 import duties. The impact of Operation Greenback since 1980 has been tremendous. When we first started Greenback, there were approximately 20 large exchange houses laundering narco-dollars in this country. By our efforts in Miami, we have those exchange houses, which we have identified, we have put them out of business by either indictments or physically they moved out of the country.

Now what is happening, we have found that we have smaller exchange houses taking the place of the others that we have put out of business. However, they are charging a much larger gross profit percentage, or the spread for the dollars that they buy and they sell is much larger now than when the larger exchange houses were operating. We have selected, for producing to you, out of 129 cases, 7 cases. The amount of deposits to these individuals' bank accounts in Miami from 8 months to 3 years, total $1,818 million. Keep in mind that these amounts represents costs of goods sold to the domestic narcotics trafficker.

We estimate that at a rate of 1 to 10, this would represent $18 billion in narcotics sold in the streets of this country. The domestic narcotics trafficker which makes huge profits from this illicit business, will then use the offshore banks, the offshore corporations to bring back into the United States these narcotics traffic profits. Operation Greenback has also enforced compliance by banks filing forms 4789, which is the currency transaction reports.

In 1981, there was a 400-percent increase based upon the 4789's filed by banks in the Miami area. Also in Greenback, we have found that the narco-traffickers have tried to develop new trends to run their illicit profits. Some of the trends are opening several bank accounts and making daily currency deposits for less than $10,000, laundering funds through legitimate domestic businesses, laundering funds through casinos in Las Vegas and Atlantic City, using banks in other areas of this country such as Puerto Rico, New York and purchasing cashiers checks for less than $10,000.

In addition to the statistics of Operation Greenback, which were mentioned yesterday, we have approximately $129 million in tax assessments and terminations due to the efforts of Operation Greenback. We also have 94 indictments, which is broken down as follows: 25 convictions, 62 pending trials, 4 acquitals, and 3 dismissals. These are the statistics related to Internal Revenue's cases only. Some of these individuals that have been indicted, may also have been charged on Customs violations. The individuals charged under Customs violations only, are not included in the statistics I previously gave you.

Do you have any questions; sir?

Chairman ROTH. Yes. Thank you for your very interesting testimony. Let me ask you one question.

As you pointed out, these illegal operations are not only using U.S. money and helping encourage narcotics, but it is also affecting Colombia because there is a black market of duties. How serious a problem is that for the Colombia Government?

Mr. DEARMAS. They estimate that underground narcotics money coming into Colombia comprises between 25 to 50 percent of the total gross national product. And perhaps it affects inflation in Colombia to the extent of between 10 percent to 25 percent a year.

Chairman ROTH. From your own experience, is there a great deal of cooperation with the Colombian Government and ours in trying to eliminate this kind of operation?

Mr. **Dearmas**. Yes, sir. We have received excellent cooperation from all levels of the Colombian Government.

Chairman **Roth**. Did you hear Mr. Ghitis testify this morning about how his exchange operation worked?

Mr. **Dearmas**. Yes, sir. I did.

Chairman **Roth**. I wonder if you would care to comment on his testimony?

Mr. **Dearmas**. First of all, I would have to take exception to Mr. Ghitis' portrayal of the agricultural product that he was involved with. He referred to coffee.

Chairman **Roth**. Referred to what?

Mr. **Dearmas**. Coffee. He referred to coffee as being the main agricultural product that gave him the U.S. dollars in this country to buy. I take exception to that. Our investigations, both in this country and in Colombia, revealed the main agricultural product that Mr. Ghitis was involved in was either marihuana or cocaine instead of coffee.

Chairman **Roth**. What percentage of that cocaine comes to the United States and to what extent is it exported to other countries? Do you have any idea?

Mr. **Dearmas**. No, sir.

Chairman **Roth**. In your experience, how are offshore banks and companies used by traffickers?

Mr. **Dearmas**. Very simple, Senator. The mechanics of the narcotics trafficker is as follows: Let us assume the domestic narcotics trafficker buys 100,000 pounds of marihuana. He pays $200 a pound. He would then get a profit of approximately $100 a pound. The money will come to him little by little. At one point in time, he will have accumulated millions of dollars. So what can he do with that money? By creation of offshore operations, he is able then to buy legitimate businesses in this country and is able to invest in other businesses outside of this country. He is able to bring some of his narcotics profits back into the banking system by using these offshore banks and offshore corporations. We have specific cases in which individuals, one individual has formed 12 corporations in Panama, Caymans, Netherland Antilles, Bahamas, and this is a new one for me. An island off the coast of Great Britain, which I never knew they were using that island as an offshore, but through that corporation, he channeled, he was able to channel back into the United States $3 million in currency from 1980 through December 1981.

Chairman **Roth**. $3 million?

Mr. **Dearmas**. $3 million in currency, sir.

Chairman **Roth**. Let me ask you a question with respect to Operation Greenback. You played a very important role and I want to congratulate you for your contribution there. I wonder, based on your experiences, what additional tools you feel are needed to—I'm not asking you to speak on behalf of your agency—I am wondering from your own standpoint, what would you recommend perhaps this subcommittee or Congress to do to help? What additional legal tools do you need?

Mr. **Dearmas**. It would be of great help to us to be able to obtain bank records from those countries.

Chairman **Roth**. To obtain bank records?

Mr. **Dearmas**. Yes, identifying the account holders in those countries. In my opinion, that would be the most significant tool that we would have, to be able to fight back illicit traffic of narcotics in this country, if you try to investigate those large narcotics traffickers who have, for years, evaded income taxes in this country.

Mr. WASSENAAR. Mr. Chairman, I might add a couple of things to that.

It is my understanding that there are apparently no civil proceedings, or provisions for the fraudulent use of form 4789, or failure to file form 4789. I would think that if a large amount of currency is deposited in the banking institution requiring the completion of that form, if such form is not completed, accurately or if it is completed fraudulently, or if one is not completed, I think it would be beneficial if there were civil forfeiture provisions wherein, that money, the money that was deposited could then be seized.

In the same manner, that Customs currently has the seizure authority when a CMIR is not properly prepared on the transmission of in excess of $5,000 across the border. I think one other point would be helpful to IRS in particular. Many of our investigations, because they are very complicated in nature and we have a great deal of difficulty in attempting to obtain the records, many of these investigations must be worked with the use of the Grand Jury. While the grand jury process is very effective, I think in obtaining necessary evidence from a criminal standpoint, frequently we find that the extensive efforts made by the IRS in working with a grand jury to obtain a criminal conviction does not enable us to proceed civilly, with respect to the evidence uncovered. As I am sure you are aware, the court must authorize an order for the use of this information to be used for civil purposes and we are finding an increasing number, greater number of courts reluctant to provide such an order.

So we have, in many respects, been very successful in the use of the grand jury for criminal convictions and it is a good investment on our part. But the IRS in many cases is almost handcuffed in terms of proceeding civilly on any successful criminal case because of the grand jury problem.

Chairman ROTH. Mr. Weiland.

Mr. WEILAND. Just to follow up on that thought of possible congressional action, Mr. Wassenaar, and so the record is clear, would the Service favor an amendment to title 18 which would provide for wiretap authority based on title 31 violations?

Mr. WASSENAAR. I am not sure if I could speak on behalf of the Service in that respect. From a personal standpoint, strictly from a personal standpoint, I am not sure that I would favor that. It might help us in gaining information in certain cases but providing the Service with title 3 wiretap authority I think the price we would have to pay in terms of the misperception of the public might be greater than the rewards received from utilizing it in certain criminal cases.

Mr. WEILAND. But what about generally, just in terms of amending the wiretap law to permit the use of bank secrecy violations as a predicate for the U.S. attorney to seek court order?

Mr. WASSENAAR. Yes; I would have no problem with that. I think there should be a clear distinction however, that title 3 wiretap authority not be provided in title 26 cases.

Mr. WEILAND. Finally, just, Mr. Chairman, a general question for Mr. Wassenaar. It is fair to say that your criminal investigators have continually faced a tremendous problem with this wall of secrecy of various tax havens, particularly over the course of the last few years?

Mr. **Wassenaar**. Absolutely. As I indicated in my testimony yesterday, I do believe, clearly committed to the fact that our agencies are the best financial investigators in the world. They are able to track the flow of money better than anyone, especially money that circulates within this country. But once that money leaves this country, if it is destined to a foreign tax haven, the veil of secrecy is brought up and that trail stops. It stops immediately. I am convinced that is the primary reason why many of these countries have bank secrecy laws; to prevent the trail being followed by our agents.

Mr. **Weiland**. Do you have any idea as to how many of your investigations have had to be curtailed or terminated say, in the last 2 to 3 years because of your inability to secure records from offshore jurisdictions?

Mr. **Wassenaar**. I do have some figures on that. It will take me a second to find it.

In the past few years, we have worked approximately 500 cases involving tax haven countries. At least 121 of those 500 cases were discontinued or declined. Of that number, 47 percent were discontinued or declined because the records of the foreign countries were not available.

Chairman **Roth**. Gentlemen, thank you for your testimony. If we have any further questions, we will contact you at a later time. Again, we would be interested in any suggestions or recommendations as to what additional congressional actions might be helpful.

Mr. **Wassenaar**. Thank you.

Mr. **Dearmas**. Thank you.

Chairman **Roth**. Thank you.

The subcommittee is in recess.

[Senator present at the time of recess was: Senator Roth.]

[Whereupon, at 3:15 p.m., the subcommittee was recessed, to reconvene at the call of the Chair.]

CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES

TUESDAY, MAY 24, 1983

U.S. Senate,
Permanent Subcommittee on Investigations
of the Committee on Governmental Affairs,
Washington, D.C.

The subcommittee met at 10 a.m., in room SD–342, Dirksen Senate Office Building, under authority of Senate Resolution 76, section 13, dated March 2, 1983, Hon. William V. Roth, Jr. (chairman of the subcommittee) presiding.

Members of the subcommittee present: Senator William V. Roth, Jr., Republican, Delaware; Senator Warren Rudman, Republican, New Hampshire; and Senator Lawton Chiles, Jr., Democrat, Florida.

Members of the professional staff present: S. Cass Weiland, chief counsel; Eleanore J. Hill, chief counsel to the minority; Rod Smith and Jim McMahon, deputy chief counsels; Chuck Morley, chief investigator; Katherine Bidden, chief clerk; Tom Karol, staff counsel, majority; Tom McLaughlin, staff investigator, majority; Glenn Fry, staff investigator, minority; Cindy Cappel and Mitch Goldberg, staff persons.

[Senator present at convening of hearing: Senator Roth.]

[Letter of authority follows:]

U.S. Senate,
Committee on Governmental Affairs,
Senate Permanent Subcommittee on Investigations,
Washington, D.C.

Pursuant to rule 5 of the Rules of Procedure of the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, permission is hereby granted for the chairman, or any member of the subcommittee as designated by the chairman, to conduct open and/or executive hearings without a quorum of two members for the administration of oaths and taking testimony in connection with hearings on Crime and Secrecy: The Use of Offshore Banks and Companies to be held March 15, 16, and May 24, 1983.

William V. Roth, Jr.,
Chairman.
Sam Nunn,
Ranking Minority Member.

OPENING STATEMENT OF SENATOR ROTH

Chairman Roth. The subcommittee will be in order.

Today, the Permanent Subcommittee on Investigations holds its second in a series of hearings on the abuses of offshore banks, and companies.

In our first hearing in February, the subcommittee heard testimony illustrating the enormous size and variety of criminal use of these foreign entities. In today's hearing, the subcommittee will illustrate the problems presented to U.S. regulatory authorities by these offshore banks and companies because of the foreign secrecy and blocking laws.

The subcommittee will also examine the growing phenomenon of bank brokers, individuals who charter offshore entities for the sole purpose of reselling these entities to U.S. clients.

We will initially concentrate on the use of foreign secrecy laws to thwart U.S. regulatory efforts. Foreign secrecy and blocking statutes have been used to prevent the effective regulation of foreign entities involved in U.S. financial markets.

These foreign entities benefit from the integrity of the U.S. financial markets but may use their domestic statutes to prevent U.S. regulators from obtaining information that is necessary to insure that integrity.

Later today we will deal with the proliferation of persons selling offshore banks inside the United States. These banks in such far away places as Anguilla and other little known areas, often consist of little more than a file folder in an agent's drawer but are merchandised as the gateway to vast foreign fortunes and complete privacy.

The actual use of these banks are unclear and raise many substantial questions as to reliability and accountability. The information provided this morning, hopefully, will present a clearer view of this situation.

We are very pleased at this time to have before us John Fedders, who is the Director of the Enforcement Division of the Securities and Exchange Commission.

Mr. Fedders, under the rules of the subcommittee, all must be sworn in, so we would ask you and your colleagues to please rise and raise your right hand.

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. FEDDERS. I do.

Mr. WADE. I do.

Ms. MORRISON. I do.

Mr. MANN. I do.

Chairman ROTH. Thank you.

Mr. Fedders, if you could, we would ask that you summarize your statement and the full statement will be included in the record, as if read.[1]

Please proceed.

TESTIMONY OF JOHN M. FEDDERS, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY FREDERICK B. WADE, CHIEF COUNSEL, DIVISION OF ENFORCEMENT, ALEXIS MORRISON, CHIEF LITIGATION COUNSEL, DIVISION OF ENFORCEMENT, AND MICHAEL MANN, ATTORNEY, DIVISION OF ENFORCEMENT

Mr. FEDDERS. Thank you, Senator.

I would like to introduce three of my colleagues, who have accompanied me today.

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[1] See p. 318 for the prepared statement of John M. Fedders.

To my right is Fred Wade, who is the Chief Counsel of the Division of Enforcement; at my far left is Alexis Morrison, who is Chief Litigation Counsel of the Division of Enforcement; to my immediate left is Michael Mann of the staff of the Division of Enforcement.

In Government service, I would say these three individuals are the most knowledgeable litigators and persons who deal in the area of foreign blocking and secrecy laws in trying to overcome them in order to preserve the integrity of our markets.

Chairman ROTH. I want to welcome all of you.

We are very pleased you can be here today.

Mr. FEDDERS. Thank you.

It is a pleasure to testify about the impact of foreign secrecy and blocking laws on the Securities and Exchange Commission's efforts to protect investors and police the U.S. capital markets. I will address problems encountered in investigations and litigation because of foreign legislation restricting discovery and explore approaches which may resolve the difficulties.

We are in the midst of rapid internationalization of the securities markets. The capital markets of each nation, particularly our own, are increasingly affected by events initiated outside their borders.

Foreign participation in the U.S. securities markets has increased dramatically. From 1978 to 1982, transactions in the United States by foreign financial institutions involving stocks and bonds increased from $23.6 billion to $53.1 billion. Total foreign investment in the United States increased from $25.6 billion in 1971 to $42.4 billion in 1978 and to $99.2 billion in 1982.

Obviously, this increase has been accompanied by a rise in transactions from jurisdictions which have secrecy or blocking laws. I am not implying that all, or even a small part, of those transactions from those jurisdictions are fraudulent.

However, their laws impede, and sometimes foreclose, the Commission's ability to monitor our markets and insure their integrity. They provide a means for wrongdoers to threaten the fairness of our market system.

The Commission's Chairman, John Shad, has said, "America's securities markets are by far the best the world has ever known—the broadest, the most active, efficient and fairest."

Our markets also are the best managed, surveilled, and policed. It is the fairness of our markets which attracts foreign capital. Without jeopardizing the attractiveness of our markets to foreign investors, we must assure the Commission's ability to maintain the high integrity of those markets.

I will discuss how secrecy and blocking laws impede Commission investigations, and our efforts to overcome foreign laws restricting discovery. Before I do so, however, I want to emphasize that I am not proposing extraterritorial application of U.S. laws or threatening the sovereignty of other nations.

I am, in fact, addressing extraterritorial application of foreign laws to impede and frustrate the Commission's efforts to preserve the integrity of our capital markets.

At issue is the sovereignty of the United States, and the Commission's ability to protect investors.

The U.S. Supreme Court has articulated the principle that those who purposefully avail themselves of the privilege of conducting activities within a State, thus, invoking the benefits and protections of its laws, thereby submit to the jurisdiction of that State.

We must recognize that individuals or entities effecting transactions through foreign financial institutions on the U.S. securities markets engaged in conduct within the United States.

[At this point, Senator Chiles entered the hearing room.]

Mr. **Fedders**. The conduct is a deliberate invasion of the territory of the United States. If secrecy or blocking laws are asserted to cloak the transactions and impede our investigations, then there is an affirmative infringement of U.S. sovereignty and the Commission's mandate to preserve the integrity of our markets.

The U.S. securities laws must apply, and be applied, to anyone engaging in conduct in our capital markets. Those laws must permit the investigation and prosecution of persons in any nation who engage in fraudulent transactions in our securities markets.

Now permit me to discuss the practicalities of the problem.

The Commission investigates a wide range of market activity and corporate disclosure. Normally, where a suspicious transaction occurs, the Commission's enforcement staff requests trading records of the broker and customer involved and takes testimony to determine whether illegal conduct occurred. Similar action is taken when investigating the adequacy of corporate disclosure. Let me give you examples how our efforts are impeded by secrecy or blocking laws.

First, I will give you a hypothetical dealing with secrecy laws in a market fraud manipulation. Suppose XYZ Corp. plans a tender offer of the shares of ABC Corp. Furthermore, suppose either an officer of XYZ or one of its professional consultants misappropriates material nonpublic information concerning the unannounced tender offer, and places a purchase order for the securities of ABC through a bank in a secrecy jurisdiction. If the transaction had been conducted through a U.S. brokerage firm, the Commission could quickly identify the individual involved. However, because the transaction was effected through a bank in a secrecy jurisdiction, the Commission would be denied access to the information necessary to determine whether a securities law violation had occurred.

Chairman **Roth**. Could I interrupt a minute and ask you, can you simplify that illustration so that all of us who are lay people understand what you are talking about? Give us a sample illustration of exactly what the problem is.

Mr. **Fedders**. A simple illustration would be if John Fedders, as an executive of a public company, learns material nonpublic information. With the ease with which a secrecy account can be opened in one of the havens that has secrecy laws. I telephone my agent at that bank in the foreign jurisdiction and I say you have *x* number of dollars in my account there, please execute a transaction for the securities of XYZ Corp. I am taking advantage of material nonpublic information.

Now the announcement is made of the tender offer—as I used in the hypothetical—and the Securities and Exchange Commission begins an investigation. In surveilling the marketplace before the announcement of the tender offer, the staff notices this large purchase, let us say, and they begin to do an examination. They may request the broker involved to do what we call a blue sheet, and suddenly we learn that there was a bank in a secrecy haven through which the transaction was conducted. We place a telephone call or subpena that institution for the identity of the individual involved. They say, "Sorry, we cannot provide the information." When that event occurs, we begin to devote enormous resources, as I will say in my testimony, on a 10-to-1 ratio. Extra manpower necessary to begin to pursue that potential violation and notwithstanding the efforts we put forward, the possibility of success is minimal.

Chairman **Roth**. In other words, for example, if I were an insider and had certain information, one way of operating safely would be to go to one of these offshore banks, is that right?

Mr. **Fedders**. That's correct, Senator.

Chairman **Roth**. It would be very difficult for you to discharge your responsibility under the law?

Mr. **Fedders**. It is.

Chairman **Roth**. And it involves U.S. law and U.S. sovereignty is what you are saying?

Mr. **Fedders**. Exactly.

Chairman **Roth**. Please proceed.

Mr. **Fedders**. The second hypothetical I will provide to you is a blocking law example. Blocking laws, strangely enough, are not well understood by many people and it is not well understood how they can impede law enforcement in our country. The hypothetical involves not a market fraud but disclosure fraud. Let us suppose the Commission is investigating fraudulent disclosure of a U.S.-based multinational corporation with a significant subsidiary in the country with blocking laws. The enforcement staff would subpena the U.S. parent requesting production of the foreign subsidiary's books. If the records were in the United States, the staff could quickly obtain them. However, if the records were maintained by the subsidiary in a country with blocking laws, the Commission may be impeded from obtaining the same documents it could routinely subpena from the U.S. offices of the corporation. Typically, the Commission staff is told that it would be a criminal act in the foreign jurisdiction for the corporation's foreign subsidiary to supply the information.

[At this point, Senator Rudman entered the hearing room.]

Mr. **Fedders**. In the market fraud example, the Commission could initiate various diplomatic or litigation steps in an attempt to obtain the identity of the customers or the records involved. If assets remain in the United States, the Commission might seek a court order freezing those assets. Furthermore, it could elect to file a John Doe complaint even without knowing the identity of the individuals involved and the reasons for their conduct. Thereafter, it might file a motion in Federal court to compel the foreign financial institution involved to disclose the names of its customers or to produce the subpenaed records.

Other expensive and time-consuming alternatives also are available. But the point that needs to be made is that, even after these steps are taken, secrecy and blocking laws can frequently defeat the Commission's efforts.

What in fact has developed is a double standard, a de facto double standard for the enforcement of the securities laws. One standard exists for those located within the United States, and a lesser standard for those trading within the United States but from beyond our borders.

As securities laws violators increase their use of intermedaries outside the United States, the integrity of our markets is threatened.

Chairman ROTH. You really have a loophole that can swallow the whole, is that true?

Mr. FEDDERS. It is not only a loophole but it in fact is a series of laws that are developing as we go through the internationalization of our capital markets that say: "U.S. citizens, you are trading in our marketplace, you can play by one rule. The Commission can scrutinize with the greatest care your conduct." If a person steps behind the screen of secrecy or blocking laws, it is a new standard because they can trade in our markets, indeed we invite them in our markets to continue to promote the capitalist system, but then when we attempt to identify their transaction, who they are and the reasons for their conduct, they quickly step behind the secrecy available or availability of a blocking law and impede our investigation.

Chairman ROTH. In other words, they want to play in our yard but not by our rules?

Mr. FEDDERS. Exactly, Senator.

There are two significant cases that I have included both in my prepared oral statement and my written statement. For the purposes of expediting the process, I will not discuss what is called the *Santa Fe* case and let both my prepared oral and written testimony speak for itself.

I would like to take a few minutes and discuss for you a case called the *St. Joe Minerals Corp.* It was litigation initiated by the Commission in 1981 which involved transactions in the common stock and call options for the common stock of St. Joe Minerals Corp. just prior to the announcement of a takeover bid for that corporation. The case represents the most significant achievement the Commission has had in combating secrecy laws through litigation.

After the bank in that case refused to provide needed information, we made efforts through the Department of Justice and Department of State and also with the Swiss Government to avoid compulsory litigation. There were no solutions available at the time and as a result, a motion was filed in the Federal court seeking to compel production of the requested information.

In November 1981, Judge Milton Pollack of the U.S. District Court for the Southern District of New York granted the Commission's motion and ordered the bank to disclose its customers' identities or risk substantial sanctions.

I will provide you two quotes that Judge Pollack has rendered in this opinion which stand for the backbone of the integrity of our capital markets and how they cannot be jeopardized by these laws.

First, Judge Pollack said:

> The strength of the United States interest in enforcing its securities laws to insure the integrity of its financial markets cannot seriously be doubted. That interest is being continually thwarted by the use of foreign bank accounts.

He went on to say:

> It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonyminity under foreign law.

After this decision, the bank obtained a waiver from its customer and quickly provided the identity of the individual.

As Judge Pollack has said, the securities laws represent a "vital national interest" of the United States. Judge Pollack's decision in and of itself is an important precedent, but the case-by-case method for analyzing whether production of information will be compelled is not the most effective deterrent against securities laws violators.

It was an extraordinary solution for an extraordinary case. If secrecy had not been interposed in the *Santa Fe* case to which I referred to and in the *St. Joe* case, which I described, each could have been resolved with approximately one-tenth the amount of Commission resources.

While greater enforcement resources would enhance our efforts, such increases would be no more than a band-aid solution. Effective enforcement requires deterrence. Potential violators must be deterred by the fear that their conduct will be scrutinized if they use secrecy or blocking laws to conceal their identities or business records.

While we do not wish to impede capital formation or the continued internationalization of the U.S. securities markets, investors must be protected. Workable solutions must be sensitive both to the needs of enforcement and to the sovereignty of other nations.

The solutions must be found both in the international arena with agreements among the active trading nations and domestically with laws which improve our ability to conduct investigations and prosecute enforcement actions.

The Swiss, for example, have shown great interest in devising methods to assist the Commission in fulfilling its mandate. Their efforts in this regard deserve great praise and respect.

The Commission staff assisted in the negotiation of the 1977 U.S. Swiss Treaty on Mutual Assistance in Criminal Matters. This treaty, one of the first of its kind, has provided some assistance in policing U.S. securities markets.

In August 1982, as an outgrowth of the *St. Joe* and of the *Santa Fe* cases, the Commission concluded 6 months of consultations with the Government of Switzerland. A memorandum of understanding was executed to supplement the 1977 treaty.

This memorandum of understanding provides that, for certain insider trading cases in which information cannot be obtained under the 1977 treaty, a private agreement among members of the Swiss Bankers' Association who trade on U.S. securities markets would apply.

[The operation of the memorandum of understanding and the private agreement between Switzerland and the United States was marked "Exhibit No. 16," for reference, and may be found in the files of the subcommittee.]

Mr. **Fedders.** This private agreement provides an alternative method for the handling of requests from the Commission in insider information cases involving a tender offer or other business acquisition.

The United States-Swiss memorandum of understanding represents a landmark agreement. It demonstrates what can be achieved by two nations in the area of mutual law enforcement cooperation. It provides an important vehicle for the Commission when investigating insider training cases where Swiss accounts have been utilized.

Without the Swiss commitment to finding a solution to this problem, our consultations would not have succeeded.

The Commission's vitality as an enforcement agency depends upon its ability swiftly to investigate suspicious activity in our securities markets or failures to disclose material information.

The Commission needs means to attack the problem, tools to assure its ability to complete investigations and enforce the securities laws against those who use our markets for fraudulent activities.

There are many other nations with secrecy and blocking laws which offer anonymity to investors with respect to banking and financial transactions.

Your staff requested that I pose questions for this subcommittee to consider during its important deliberations. They asked that I raise issues concerning possible legislation to assist the Commission's enforcement effort.

Before I pose questions, I want to point out that they are my own and do not necessarily represent the position of Chairman Shad of the Commission or commissioners, the President, or the Office of Management and Budget.

The questions are as follows: First, does the Commission need legislation that will put all persons on notice and provide by operation of law that the act of effecting a securities transaction in the United States constitutes a waiver of any secrecy provision that a person or an agent may waive?

Second, does the Commission need improved means for obtaining the assistance of a U.S. district court, during an investigation, in requesting and obtaining information from persons or institutions located overseas?

Third, would it be helpful if legislation were enacted providing that the act of effecting a securities transaction in the United States shall constitute the appointment of the U.S. broker dealer used as an agent for service of process with respect to any commission enforcement action or any statutory action that might be initiated to assist the Commission in seeking information in the course of its investigation?

And, fourth, to further elminate problems in conducting investigations and prosecuting enforcement actions, should legislation be enacted, providing that the act of effecting a securities transaction in the United States shall constitute a consent to the jurisdiction of the U.S. courts with respect to any action that might arise out of the transaction?

Since neither the Commission nor its Division of Enforcement has carefully analyzed the cost effectiveness and relative merits of affirmative answers to these questions, legislation is not recommended at this time. However, during the question-and-answer period, I would be glad to address each of these.

In conclusion, protecting investors and maintaining the integrity of the U.S. capital markets requires vigorous enforcement of the securities laws.

This is essential to maintain investor confidence that the marketplace is fair and honest.

With increased foreign transactions taking place in the United States, we must decide whether the Commission has adequate enforcement tools to protect the American markets.

As it now stands, there are two sets of rules: One for those located within the United States and a lesser standard for those trading within the United States but from beyond our borders.

We must send a clear message to all persons who save and invest in the U.S. securities markets. "We welcome your participation, but you cannot expect preferential treatment. If you want to trade in our markets, you must agree to play by our rules."

Thank you, Senator.

Chairman ROTH. Thank you, Mr. Fedders.

If I understand your testimony, what you are telling me is that any unscrupulous person, international pirate—and that is what they are—has a way or means of avoiding the enforcement procedures of the SEC; is that correct?

Mr. FEDDERS. That is correct.

Chairman ROTH. All they have to do is go outside; it can be either an American or a foreign national?

Mr. FEDDERS. That is correct. We are making some progress, as we demonstrated in the *St. Joe* case, in being able to pierce these secrecy veils.

However, the resources——

Chairman ROTH. Let me ask you this: Has that case been followed, generally speaking?

What you are really asking is, possibly that case should be codified into law; is that correct?

Mr. FEDDERS. The codification of case law with respect to the principle—if you trade in our markets, you must play by our rules—is one of the approaches that could be taken.

There are a number of decisions in this area, the *St. Joe* decision as we talked about, there is a *Vestco* decision involving the Internal Revenue Service, there is a bank case growing out of a grand jury procedure.

A codification of these cases could avoid one thing: it would avoid relitigation of those issues in the various circuit courts and could avoid conflicts in the various circuits.

It would set down clear principles articulated by the Congress as to how the courts should respond to these situations.

Chairman ROTH. Let me play the devil's advocate for a minute and make sure I understand.

If your statement, if I understood it, this does not involve foreign sovereignty, it really involves our markets and the rules by which our markets operate, and if they want to play here, they ought to abide by our rules.

The fact is that, in a sense, by saying that foreign nations or foreign instrumentalities have to comply and abide with our laws, gives ground for those people to claim that that is an extraterritorial impact of our laws.

Mr. FEDDERS. That is one of the arguments that we frequently confront, Senator, but let's really analyze the transaction. I don't judge your analysis as superficial. You said you were playing the devil's advocate.

Chairman ROTH. You won't be the first.

Mr. FEDDERS. If the person from the secrecy haven wants to institute a transaction in our markets, he wants the protections of our laws.

If he was defrauded in the transaction, he would undoubtedly seek to bring an action under the Federal securities laws in a private civil damage action.

So he wants to play in our game, he wants to enjoy the benefits and the protections of our laws, but he must suffer the consequences with regard to the integrity of the marketplace.

Why do people come here? Why is our market the safest, soundest, best, and most efficient? It is no accident. Sure, it has a lot to do with the integrity of our whole system. It has to do with the policing of our markets, the stability of our country, and the stability of our economy is based on the ability to investigate and prosecute wrongdoers.

Chairman ROTH. I think there is great merit but, again, let me play the devil's advocate. For example, we had a great confrontation, international confrontation, recently where we attempted to make foreign subsidiaries or companies comply with certain rules and procedures.

We did not think there should be technology transfers in conflict with our laws here because these American corporations transferred the technology to foreign subsidiaries who are also bound by the laws of those States.

It seems to me one of the points you make, which I have to agree with, is the best way to resolve this problem if we could, would be by international agreement.

I don't think you would argue with that, would you, that we could avoid some of these questions of sovereignty?

Mr. FEDDERS. I would not at all. One of the problems that you have is, what international forum do you use? We certainly do not want to begin to negotiate with each nation that has a secrecy and a blocking law, the kind of agreement that the Swiss negotiated and we consulted with them about.

Chairman ROTH. That is what bothers me. The Swiss have been apparently, from what you say, fairly cooperative. Frankly, some of these little islands who found a source of revenue are not that cooperative.

As I say, it is a new kind of international piracy, as far as I am concerned. I agree with you that while the international agreement is the best way to go, it is extraordinarily difficult.

Listen, would it help in your judgment to try to get the major industrial nations to agree and then have them try to work with some of these island countries?

Mr. FEDDERS. I think it would. Let's talk about the program. We are trying to solve a problem and we scope it out in today's economy and the way today's markets work—but let's be futurist for a second.

Let's talk about what the problems are going to be in several years. There are futurists who do more thinking than I do about the future, and suggest in a few years we will have stock markets that operate 24 hours a day, 7 days a week, and they operate worldwide with a sophisticated communication system. Therefore, we are going to have a complete and fulfilled internationalization of the capital markets.

How are we going to police those markets? I suggest the solution is not only one that the United States has an interest in. All nations are going to have an interest in preserving the integrity of that market I just described.

When we address the issue today, why aren't we rushing into a solution—for several reasons I can see. First of all we want to do nothing that jeopardizes the United States, and in particular New York, as the financial capital of the world. We want to propose no solutions that drives trading offshore or that promotes trading in other countries.

Second, this is one of many problems with regard to international law enforcement. The decisions of the executive level, by the Department of State and the Department of Justice override and have an important impact on some of the Commission's considerations, and we must not address these problems only as they exist today. We must be futurists in trying to come up with solutions. My main concern is to propose solutions that do not jeopardize the United States as the financial capital of the world. We cannot drive these transactions offshore.

Chairman ROTH. I agree with what you are saying very strongly. Of course, as you point out in your opening statement, the problem is growing dramatically I assume from what you are saying. You say there is an increase in transactions by foreign institutions, a growth from $23 to $53 billion from 1978 to 1982. I assume these same trends are going to continue.

What do you predict in the future?

Mr. FEDDERS. The economists say they will. Last evening I was talking to Chairman Shad about this growth problem. He tells me that in each of the last three decades, the 1950's, 1960's, and 1970's, that the volume on the trading markets in this country has tripled in each decade and there is no reason to believe they will not be a tripling in the decade of the 1980's. The growth of foreign transactions in our U.S. markets is not a phenomenon of the 1950's and 1960's. You will see a slow growth there, but the acceleration has occurred in the last decade.

The communications system has given people the ability to come into our markets more rapidly and benefit more efficiently with the speed by which the transactions are executed here.

Chairman ROTH. From all over the world?

Mr. FEDDERS. Correct, and these communications systems will become more effective and with greater speed. It leaves us at the Commission to believe the internationalization of our markets will continue to accelerate as the volumes on the markets accelerate.

Chairman ROTH. My time is up. I just have one more question. So, because of this internationalization of our markets, if we are not able to deal with the problem, it seems to me what you are saying is that SEC or any regulatory agency will not be able to function effectively, will not be able to protect the investor.

Let me ask you this. Has your agency taken this up with the State Department or others? Are there any efforts being made now to attack this problem on a multilateral basis that you are aware of?

Mr. FEDDERS. The State Department and Department of Justice were enormously cooperative with us in both the *St. Joe* and *Santa Fe* cases, and in connection with the consultation with the Government of Switzerland. I could not ask for greater cooperation from the men and women of those two agencies. They are sensitive to the problem. They have been very helpful to us. It is one of an enormous series of problems in this area of international law enforcement. There are international agreement solutions available, there is the litigation process available, there is the congressional and lawmaking process available.

Coming upon the right process that will not only have an impact today, but will deal with these futuristic problems we are discussing is very important. This market is going to change in the next decade. This is what we really need to worry about, and I suggest that other free nations, capitalistic nations, are as concerned as we are. We just need to find the right forum now to discuss the solution.

Chairman **Roth**. It does seem to me, though, that we can't wait indefinitely because of this constant change. I think that is going to be the trade of the future. Communications is a factor. You are going to see an explosion of growth and probable changes in the market. In the meantime, it would seem to me appropriate in the executive branch of the Government that they again consider initiating some kind of discussions with other capitalistic private market countries to try to reach some international agreement, do you agree with that?

Mr. **Fedders**. I do. I hope these important hearings will serve as a stimulus to accelerate the thought not only in Congress but in the executive and other agencies, and the thoughts of scholars to think about solutions to these problems. There is an organization of which the Commission on behalf of the U.S. Government is a member called—the name escapes me now. It is made up of many nations—the InterAmerican Securities Conference of Securities Commissions and Similar Organizations made up of nations in this hemisphere and others that discuss securities problems.

We only meet once a year and you can't accomplish a great deal in 1 week once a year. That is one of the vehicles that could be used for important thinking and legislation in this area.

Chairman **Roth**. I appreciate your testimony. I am hopeful—we certainly intend to follow through to see if we can't actively have the executive branch take broader action.

Senator Chiles.

Senator **Chiles**. Thank you, Mr. Chairman.

Mr. Fedders, you pose some very interesting questions. You say you are not necessarily recommending these be implemented in law at this time nor is the Commission——

[At this point, Chairman Roth withdrew from the hearing room.]

Senator **Chiles**. In your testimony, you have really gone to great lengths to sort of describe the problems that you are under especially in regard to your manpower, your financial resources and your ability in trying to pierce some of the secrecy that is out there. Given those problems and trying to check these tender offers or these other securities transactions, how long can we wait until we do get some recommendations?

Mr. **Fedders**. Not very long, Senator. It is a serious problem. It is one that needs to be addressed. The kind of concerns I have, that I expressed to Senator Roth are real. We must maintain the United States as the financial capital of the world. I think that is the relative question that we have in considering any one of the four questions. If we enact these laws, can they be enforced? Will other countries be sensitive to our concern? You can enact all sorts of laws, but then trying to make application of those laws in other jurisdictions to enforce them is the difficult question. This subcommittee does not want to recommend or hear suggestions that are unenforceable. So we have to reach solutions from these various questions that I raise which our trading partners would be sensitive to because they want to enjoy the benefit of the integrity of our marketplace. But we cannot wait very long.

Senator **Chiles**. I understand that. I don't say this critically because I think it is a very good point that you make that we must be very careful that we don't drive transactions offshore. But it seems to me there is one thing more critical than that and that is we have to protect the rights of our citizens, the rights of our businesses and the rights of our stockholders. Even if we don't get a dime of foreign business, that should be the first thing we should be considering, how do we go to every degree that we need to do that. Second, I would be concerned as you are in doing what is good for our markets and good for our citizens to have the international trade that goes on. We don't want that taking place somewhere else.

I certainly recognize that. It seems like to me if we recognize that first right, it has to be for our own protection, for our citizens and our own business. Then that demands that we can't wait until we get everything solved to make everybody happy overseas. We have got to make sure that we keep the integrity of this market and by doing that, of course, we are protecting our citizens.

Mr. **Fedders**. I agree with much of what you said. I am not an isolationist. I am one who promotes international trade. I believe in it. We are doing two things, as we sit and talk with you about the solutions for the future that are more global in nature, we are litigating today on a case-by-case basis. The *St. Joe* and *Santa Fe* cases are two of several. There are ongoing private investigations which I hope you will not inquire about. These are enormously time consuming and when you undertake solutions on a case-by-case basis. We are attacking the problem. We are protecting investors, but we are doing it at the cost of enormous resources. What we are looking for are solutions where these cases can be handled as simple routine investigations.

Whether that solution is possible in our lifetime, a total solution, I don't know, but certainly major steps can be made coming out of these hearings.

Senator **Chiles**. We are seeing how fast the communication is growing. It seems to me we can see an explosion that would make the last 10 years look very slow from what we can see in the next 10 years. I don't think we have a lot of time. We are sitting on a bomb that is ticking very rapidly and the fuse is very short, too short to try to determine what we are going to do about it.

I thank you.

Senator **Rudman** [presiding]. Mr. Fedders, I only have two questions. First, you suggest a waiver provision of some kind for those who use our markets. Have you a reaction from the industry on that proposal or if you haven't, can you possibly give us your view on what that attitude might be?

Mr. **Fedders**. We have discussed the mechanics of this kind of waiver concept with some senior officials in the industry. They have said it would be a time-consuming process to get the necessary consents that would be required in order to have this automatic waiver. They also have talked about the difficulties of enforcing it. Let me give you an example.

How far do you go in obtaining identification? Let us suppose that a person who is really bent on naughtiness in our markets incorporates in one jurisdiction that has secrecy laws, reincorporates in another jurisdiction and uses the chain of corporations through, let's say, two, three, four, as many number of jurisdictions you want and we have to pierce veils a number of times and can these consents be absolute.

My colleague, Mr. Wade, to my right, has participated in some of these conversations and is really the author of the technical thought with regard to the waiver concept. If we can hear from him.

Mr. WADE. The Commission has proposed a rule, as indicated in the written testimony, in 1976, which would embody the waiver principle. In fact, it would have required that brokers in dealings before the effected transaction in the U.S. markets obtain agreement in advance on the part of the foreign international institution that they be willing to provide the identity of the person on whose behalf the effected transaction in advance. Comments on that proposal were quite negative because it would put the burden on the brokers and dealers to carry out this function and also to monitor it.

A slightly different suggestion in testimony suggests that given the fact that people coming into our markets go outside the jurisdiction of a secrecy nation, in effect engage in conduct outside their teritory and given the fact that coming into our market is purposeful, deliberate intentional conduct on their part, that perhaps provision could be made that the mere act of effecting the transaction in the United States would constitute a waiver of applicable secrecy provisions, to the extent a client or customer could engage in that voluntary waiver.

That might have an effect of both making it easier for us to pursue certain types of conduct and to the extent other nations are involved, if they recognize the voluntary waiver of their bank secrecy provisions, for example, they would not have the same kind of interest they do in their laws.

Senator CHILES. You are familiar with the CFTC rule which is designed to get behind foreign trades. It is probably a step in the right direction but possibly very hard to enforce from your point of view.

Mr. FEDDERS. Very difficult to enforce. Mr. Wade has had some experience. The CFTC rule picked up some proposals made by the Commission but not enacted.

Fred, you may want to comment on that.

Mr. WADE. That rule, in addition, puts the burden on the U.S. brokers and dealers, in fact, to monitor the transactions of people coming into our markets and assuring they comply with the Commission order that they not engage in transactions, sir.

Senator RUDMAN. Thank you very much.

The next witness will be Robert Serino, Director of Enforcement and Compliance Division of the Office of the Comptroller of the Currency.

Chairman ROTH [presiding]. Please raise your right hand. Do you swear the testimony you will give before the subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. SERINO. I do.

Chairman ROTH. I would ask that you summarize your statement and your full statement will appear in the record as if read.[1]

TESTIMONY OF ROBERT B. SERINO, DIRECTOR, ENFORCEMENT AND COMPLIANCE DIVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. SERINO. Thank you, Mr. Chairman.

I appreciate the kind invitation this subcommittee extended to me to appear before you today, and I am pleased to have the opportunity to express the views of the Office of the Comptroller of the Currency concerning the problems and abuses connected with certain offshore institutions and corporations. The subject is one that bears close scrutiny, and we commend the subcommittee and its staff for its efforts. We look forward to working with you in the future to develop solutions to these problems. The OCC's jurisdiction is limited to regulation and supervision of approximately 4,600 national banks and their branches or subsidiaries. Though we may lack jurisdiction over offshore shell banks and their licensing authorities, we are fully committed to finding solutions to the problems created by such banks because of the danger that these banks pose to the integrity and assets of the banking system.

Certain offshore banks have caused serious losses to individuals and institutions through fraudulent operations. The crisis, however, is not the size of any one loss to any one person or bank, as much as it is to the volume of such frauds being perpetrated upon a substantial number of people throughout the world. We in the Enforcement Division of the Comptroller's Office receive hundreds of calls detailing problems and complaints from individuals such as bankers or individuals because they have been approached or offered paper from an institution or one of the shell banks. At present, we are aware of approximately 125 banks that may have been involved in fraudulent operations.

I will begin with a brief overview of the nature of the problem as we see it. I will then describe the OCC's action to date and finally, I will recommend further action necessary to combat the problem. Although I have set out in my statement two problems, one being the shell bank problem and the other being the illegitimate broker problem, in light of the subcommittee's principal interest in the offshore shell bank problem, I will not discuss the money broker problem.

I have attached to my statement some memoranda which detail the broker problem. The reason I have brought this to your attention at this time is I believe that many of the problems faced by law enforcement in the shell bank cases are the similar kind of problems that law enforcement faces with the money brokers. Therefore, what I am going to do is just deal with the shell bank problem today, Mr. Chairman.

There are clear distinctions between fraudulent offshore shell bank and offshore bank offices that are being legitimately operated on the islands or by legitimate U.S. banks and long-established, large multinational banks. These latter banks are fully capitalized and well staffed and provide complete commercial and merchant banking services. Further, they maintain actual correspondent bank relationships with other large multinational banks for orderly check payment and clearing processes.

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[1] See p. 349 for the prepared statement of Robert B. Serino.

This office does not have information about the total number of offshore shell bank licenses issued nor do we know about the actual operations of all the licenses known to exist. We are knowledgeable about certain offshore shell banks that have been used as principal vehicles to perpetrate substantial frauds. These are the institutions that I wish to speak of today.

The offshore shell bank is just that, it is a shell. It is a suitcase operation. For the most part, there is no actual capitalization, no actual main office or place of business. There is no actual staff, fixed assets or other accoutrements of actual banks. A license is issued upon receipt of relative nominal fees and minimal, if any, background verification. A local person, usually a solicitor, is required to act as a resident representative. The solicitor then becomes the mail drop and the answering service. For the most part the license does not allow the bank to conduct business with the island community but only off island.

Attendant with the registration of the license is a list of banking powers which permits the bank to provide a full range of financial services.

Once an individual bent on perpetrating a fraud is in control of a bank license issued by offshore jurisdiction, it offers limitless possibilities to his endeavors. An offshore bank license enables an individual to exploit the investigative difficulties and complexities encountered with criminal activities which extend beyond the sovereign limits of a single nation. These problems are exacerbated when secrecy laws prevent cooperation with the offshore governments.

After obtaining the license, the owner-operator sets about in many ways to establish credibility. There are countless ways this can be done. The bank may assume a name similar to a major legitimate institution. It may open a checking account in a major bank and represent that as being its correspondent. It may place ads in recognized world bank directories or publications.

Once the credibility is established the shell bank may defraud the public and legitimate banks in several ways. Many ways I have listed in my statement.

The fraudulent offshore shell bank seldom honors any of the obligations drawn against it. However, they have established a convenient way of delaying tactics so that someone who calls to find out whether or not a particular item is good or bad is delayed on finding out whether or not it is a good or bad instrument.

Individuals are defrauded by depositing funds in anticipation of a significant return or by accepting an instrument as payment of an obligation. Legitimate financial institutions suffer losses when they permit their customers to draw against uncollected funds or to negotiate transactions with a vendor based on the backing of a phony letter of credit. Banks may also be defrauded when they make loans secured by the phony certificate of deposit and other direct obligations of the shell bank.

This is a particular problem because oftentimes a bank may not realize that in fact they have in their collateral file a document issued by a phony bank because the document is not due for several years and therefore a bank may be stuck and not realize it until the loan is due and it is then determined that collateral supporting it is phony.

The detection of fraud is hindered by delaying tactics and the skills of the shell bank operators in convincing a victim that payment may ultimately be received. It must be remembered that the paper of the bank is being spread not only nationwide but worldwide and by the time a victim steps forward, or action is taken to stop the bank, many others have already been hurt. In addition, an individual or financial institution may be slow to lose faith in the legitimacy of the transaction and to overcome the embarrassment of having been taken. One of the major ways that the fraud perpetrators delay detection is by giving representations to individuals that, in fact, in the long run, their transactions will pay up.

When a particular shell bank is identified as being potentially a subject of concern, the operators may buy time by claiming the bank is legitimate, but that one of their employees went "off the reservation" and sold instruments without authority. The operators may also simply abandon institutions under investigation and obtain new licenses to continue the fraud.

For example, over a period of several years, Kevin Barry Krown used at least five shell banks. He was eventually indicted and found guilty in several different U.S. jurisdictions. As part of his offense he contended he did not know that the banks were fraudulent and once so informed by the Office of Comptroller Currency he stopped using them.

Some offshore authorities may be uncooperative in providing information concerning the operations of the shell bank and its assets. They may provide the name of the locally appointed representative who is usually well regarded but the identity of the controlling owners may not be disclosed.

Further, bank operators are extremely careful to observe all licensing requirements and not to defraud the people on the island. In addition, some jurisdictions may not cooperate with law enforcement for fear of losing the income that the licensing fees provide. Moreover, many have strict bank secrecy laws that limit access to information. We have found that once the cooperation of the authority in a particular jurisdiction is obtained, or the jurisdiction is cracking down on licenses, individuals have turned to new jurisdictions for their licenses.

The flexibility of such an operation and its mobility throughout the world creates significant jurisdictional as well as investigatory burdens for the law enforcement community. These burdens are in addition to the already difficult task created when one seeks to piece together and prosecute a white-collar crime. It is, therefore, essential for the law enforcement agencies that are attacking the problems created by shell institutions to coordinate their investigations and share information available in different jurisdictions and agencies worldwide.

Over the past several years, the Office of the Comptroller of the Currency has noted a rapid increase in the creation of shell banks and broker loan frauds and have identified a significant number which have been involved in fraudulent operations. For that reason in late 1978, we directly contacted several offshore jurisdictions to seek their cooperation. We expressed our concern over the apparent increase in the use of offshore banks and schemes to defraud.

We requested that those jurisdictions principally in the Caribbean cooperate with our efforts and establish direct communication with us in order to, among other things: Exchange information concerning their laws and statutes, provide us with current lists of their registered banks and those banks who were subsequently struck from their list and respond to any inquiries we have when we have questions about an institution that comes to our attention.

Information developed from offshore authorities, as well as law enforcement and banks in the United States when obtained by enforcement division is reviewed.

I am the director of the Enforcement Division and one of our functions is to review the material that we receive to determine whether or not there is some information we ought to provide to law enforcement.

When we have obtained sufficient information indicating potentially fraudulent activity, we issue bank circulars. The circulars advise caution in dealing with participants, normally shell banks, and request information on transactions with them.

These circulars have helped to alert the industry to potential problems. In many instances, they have generated additional information about other transactions in different jurisdictions which confirm the existence of a true fraud. Partially, as a result of our notices and frequent direct inquiries, several jurisdictions have become concerned about their reputations for being havens for phony banks.

One jurisdiction, in fact, placed a moratorium on the issuance of licenses for about 2 years and reduced its outstanding licenses from 200 to 20.

New laws in this jurisdiction also required thorough investigations of applicants for licenses and provided stringent capital requirements and criminal penalties for obtaining licenses by fraud. Unfortunately, when the laws were tightened in that jurisdiction, the licensing activity moved elsewhere.

Information obtained by the Comptroller's Office is made available to the law enforcement community through referrals of potentially fraudulent activity and responses to daily calls from Federal and State law enforcement authorities.

We are also able to provide the identity of other law enforcement authorities investigating the same bank or individual. This coordination of sources of information is absolutely essential in putting together prosecutable cases involving shell banks.

We believe that cooperative efforts of the law enforcement community and banking communities have resulted in substantial progress toward a solution to the problem. We look forward to additional successes as we focus on new solutions.

I know the banking community and the law enforcement community are deeply committed to attacking the problem.

[At this point, Senator Chiles withdrew from the hearing room.]

Mr. SERINO. Several steps can be taken to make it more difficult to misuse a bank license. I indicated in my statement, a major area of concern as far as I am concerned, is the cooperation and communication. Improved communication between law enforcement authorities on both the domestic and international basis is essential for the prompt discovery and success of the prosecution of offshore shell banks or broker fund frauds. Where several jurisdictions are investigating similar transactions it may be important for a central source to coordinate the investigation and determine which jurisdiction would be most appropriate for initiating the prosecution.

In the United States, the need for information sharing among Federal law enforcement authorities has been recognized and working groups have been established to work toward that objective.

On the international front, I recently had the privilege of participating as a member of a working group on economic crime, sponsored by Interpol's American region along with representatives of Treasury, Internal Revenue Service, Postal Service, Customs, DEA, FBI, and Interpol's Washington National Central Bureau and several nations.

The major item on the agenda was the use of shell banks in criminal activities. The discussion focused on the need for coordination and cooperation not only in narcotics investigations but also in investigations relative to shell banks.

Several recommendations were made to the General Secretary of Interpol, which would, among other things, encourage the member countries of Interpol to aid in establishing a database that can be used in coordinating investigations.

The other suggestions we looked at in the legislative area deal with restraints on the Government to coordinate matters and the various limitations on the Government to share information with other agencies.

Another area would be to improve the banking legislation of the offshore jurisdictions. That would also include the elimination of secrecy protection for banks being used for criminal purposes.

The last suggestion, as far as legislation, would be for a review of the bank fraud statute which is presently before the Congress, as the Comprehensive Crime Control Act of 1983, which was submitted by the administration on March 16, 1983. It has a separate section, 1508, which would make it a crime to defraud a bank. Just the fact that a bank was a bank and somebody tried to perpetrate a fraud on it would be a basis for prosecution.

In conclusion, I would like to thank the subcommittee for giving me the opportunity to present the views of the Office of the Comptroller of the Currency here today. It is a subject I have been struggling with since my days starting in the Department of Justice since 1969 and one that, I believe, bears great scrutiny.

Additional public information about the abuses connected with offshore shell banks will increase the caution exercised by legitimate financial institutions and the public when dealing with those fraudulent entities.

We also hope that increased international scrutiny will convince offshore jurisdictions of the problems created by indiscriminate licensing of offshore banks.

Finally, we look forward to the continuation of our current efforts to enhance cooperation with the law enforcement community.

Mr. Chairman, I also would like, if I may, to comment. I had a brief opportunity to read a prepared statement of Mr. Schneider. He commented on the issuance by the Comptroller's Office of certain circulars.

I would like, if I may, to note that on page 12, he indicates: That working against us, with great vigor is one individual at the Comptroller's Office, Mr. John Shockey.

Mr. Chairman, I would like to state that, in fact, Mr. Shockey is on my staff. He is a senior examiner who has been with me for about the past 5 or 6 years. Before that he had examined banks extensively.

Mr. Shockey is concerned about the problem. He is not concerned specifically about Mr. Schneider. We do work with great vigor against the problem because of our experience.

While there are many shells that may be legitimate, the ones that are brought to our attention in the main have not been. The bank bulletins are not issued by Mr. Shockey, they are issued by the Comptroller of the Currency and they are issued only after we review transactions to make sure we have concern about situations.

We are not categorically stating when we issue these circulars that an institution is a fraud. We are only raising to the public the need to use caution. I suggest it is important that we issue these circulars because publicity is a major way to attack the shell bank problem.

I thank you for your time. I thank you for the subcommittee's investigation and I stand ready to respond to your questions.

Chairman Roth. Thank you, Mr. Serino.

In the Wall Street Journal on March 23, 1981, it directly characterizes "Paper pirates, conmen are raking in millions by setting up their own Caribbean banks."

[The newspaper article referred to follows:]

[From the Wall Street Journal, Mar. 23, 1981]

Con Men Are Raking in Millions by Setting Up Own Caribbean Banks

(By Jim Drinkhall)

The island of Montserrat, an 11-mile-long piece of volcanic rock in the Caribbean, was discovered by Christopher Columbus in 1493. It was rediscovered recently by a number of U.S. banks, and the experience hasn't been a pleasant one.

Now a British crown colony, the island has a permanent population of about 13,000 and isn't overrun by tourists. An old guidebook says it is famous for its "abundance of limes, papayas, avocados, coconuts and breadfruit." To which, apparently, now must be added a plethora of bank drafts, certificates of deposit, letters of credit and other banking instruments—many not worth the paper they are printed on.

Much to the distress of the U.S. Comptroller of the Currency, Montserrat and other small islands, notably St. Vincent and Anguilla, have become a spawning ground for dozens of small, shadowy private banks whose main activity seems to be turning out phony financial documents that are used in this country as collateral for loans and other illegal purposes.

According to the Los Angeles county charges, Mr. Goldstein and his partner collected a 10% advance fee in return for arranging loans for would-be borrowers. The loans turned out to be in the form of cashier's checks, certificates of deposit, or letters of credit drawn on the Montserrat bank. Still holding some of these uncollectible instruments are Bank of America, Wells Fargo and United California Bank, the court filings indicate.

William Brooks, owner of a small plane-chartering and flying-school firm in Paso Robles, Calif., can give a first-person account of what it was like to have business dealings with Mr. Goldstein. Mr. Brooks was looking for financing last September, and for a $3,000 fee, a Los Angeles money broker put him in touch with Mr. Goldstein.

Mr. Goldstein, he says, told him that the Montserrat bank would lend him $150,000 but that an advance fee of $15,000 would be required. Rather than make a cash outlay, Mr. Brooks says, he gave Mr. Goldstein 10% of the shares of his company.

In return, Mr. Brooks says he was given $150,000 of City Overseas cashier's checks. "They sure looked official, and I deposited them in my account and starting writing against them," he relates. Right off the bat, he adds, a Security Pacific Bank branch gave him $14,000 cash without waiting for a cashier's check in that amount to clear. But it wasn't long before the roof fell in on Mr. Goldstein's victim. Soon all the checks were returned as uncollectible, including one to the IRS for $15,000.

"That just about drove us into the ground," Mr. Brooks says. However, he has agreed to make good on all the checks. "It'll take some doing, but we'll make it," he says. Mr. Brooks is bitter because the U.S. banks he dealt with didn't check out the so-called Montserrat bank. But he concludes philosophically, "I needed money bad, and when you're a small-business man looking for money, I guess you're fair game."

Mr. Goldstein's operations didn't play favorites. One of his own employees, an office manager, received a Montserrat bank check as part of his wages, according to a district attorney's memo. The check was turned over to Wells Fargo Bank to buy a car. When the check bounced, the memo says, the bank repossessed the car.

U.S. banks apparently handled City Overseas checks like any others. When they sent them through the collection, no one apparently noticed that the bank routing code on the checks—55/80—doesn't exist. According to the court records, some banks sent the checks to Wisconsin because the address on the checks reads "Montserrat, WI."

Mr. Goldstein's bank instruments were printed by Jeffries Banknote Co. in Los Angeles, according to court papers. A spokesman for the printing firm confirms that Mr. Goldstein was a customer and explains, "All we do is put on paper what the customer wants." He adds, "We don't verify authenticity (of a bank). We're printers, not a detective agency."

Kevin Krown, the other bigtime swindler now in deep trouble, is also known as Barry Crown. Last year, he was convicted in Denver federal court on 25 counts of defrauding people by issuing phony bank documents, but he hasn't been sentenced yet. In Tulsa, Okla., he was recently sentenced to 10 years in prison after being convicted of three counts involving the same offshore banks. And a three-count indictment against him in Salt Lake City is scheduled for trial later this year.

In the recently concluded trial in New York federal court, Mr. Krown was charged with issuing "well over $40 million in worthless financial instruments" drawn on six fraudulent "briefcase banks" over a three-year period, according to court papers filed by the prosecutor, Assistant U.S. Attorney Carolyn H. Henneman. Mr. Krown's take from the operation, mainly in the form of advance fees on loans backed by the phony instruments, amounted to from $2 million to $6 million, the court papers indicate. The banks claimed assets of $250 million but "in fact had no assets," a government affidavit says.

Most of the allegedly fraudulent bank documents were from First London Bank & Trust Co. and First National Bank of Tehran S.A.K., on St. Vincent, according to the government's court filings.

"Headquarters" for the banks, according to court testimony in the Tulsa case, was the back room of a Kingston, St. Vincent, curio and pet shop. There, a person allegedly paid by Mr. Krown had the duty of telling callers to the "banks" that the checks and other instruments would be honored. "None of these instruments was ever honored," according to testimony in the Tulsa case as well as court papers in the other three cases. The banks left holding unpaid checks issued by Mr. Krown's banks are "nationwide," according to court papers, and range from Bank of Sturgeon Bay, Wis., to New York's Citibank.

ON A GRANDIOSE SCALE

Even after he had been indicted in Denver and Salt Lake City, says a federal affidavit filed in Manhattan, Mr. Krown "continued to commit crimes on a grandiose scale." From March to May 1980, the document continues, Mr. Krown allegedly set up two new "but equally fraudulent banks" that issued $3.5 million of phony cashier's checks that netted Mr. Krown $540,000 cash in advance fees. The affidavit indicates that even while his trial was going on in Denver, Mr. Krown was continuing to sell phony checks. He also allegedly asked a witness to lie to the jury, forged court documents and threatened a government witness, a government prosecutor charged in asking that the court set high bail for Mr. Krown.

During the Denver trial, Mr. Krown tried to strike a deal with the government. In return for leniency, Mr. Krown told authorities he had information linking fugitive financier Robert Vesco to an attempt to improperly influence the Carter administration to release American planes to the Libyan government. A judge later said that the tape-recorded conversations contained a lot of "innuendo" about the Vesco affair but nothing more. "There were no deals," says one federal official.

A BUNCH OF PAPER

Mr. Krown's lawyer, Michael Rosen at the New York firm of Saxe, Bacon, Bolan & Manley, protests that the government's multi-state actions are "a 48-state witch hunt. This isn't guns or drugs or treason. It's just Kevin and a bunch of paper." As to the charges that a number of persons and institutions have been stuck with unpaid checks from Mr. Krown's banks, Mr. Rosen says incredulously, "If someone pays on those checks without waiting for them to clear, there's something wrong with them."

There's some indication that Mr. Krown may have been launched on his offshore banking career by being victimized himself. In 1977, he was the producer of a Broadway play called "Bully," starring actor James Whitmore, according to an affidavit in New York federal court. Government documents say that Mr. Krown, in need of funds to pay salaries, bought a letter of credit from Maurice Benjamin, 68. The letter of credit issued on an offshore bank, proved worthless, and the show closed within a week, the government says.

Mr. Benjamin himself has been almost continuously under investigation by the FBI since 1947, and all his income "consists of ill-gotten gains," the Justice Department says in an affidavit. He was convicted along with Mr. Krown in the New York case.

FBI records show that Mr. Benjamin also issued millions of dollars in checks from Exchange National Bank & Trust Co., a bank he controlled on the Caribbean island of Antigua, another up-and-coming haven for swindlers. Several hundred thousand dollars in bogus checks, the FBI report says, were used to purchase meat for a now-defunct operation run by convicted swindler Anthony DeAngelis, the engineer of the great "salad-oil swindle" against American Express Co. in the 1960s. In a deposition in a civil lawsuit in federal court in Jersey City, Mr. Benjamin allows that he was a "consultant" for Mr. DeAngelis "to handle his debts.".

PHILLIP KITZER

No article on offshore bank thievery would be complete without at least a passing reference to another legendary con man. Phillip Kitzer, who, like Kevin Krown used shell banks on St. Vincent as money machines. Between them, the two men are believed to have issued at least $100 million in bogus bank paper. Kitzer was put away in 1977 for illegally getting advance fees through the use of phony banks. His down-fall came when he took in two proteges he later nicknamed the "junior G-men" because of their conservative dress. As it turned out, they were FBI agents.

One unusual offshore banking operation has never been charged with any wrongdoing but still has bank regulators edgy, they say. It is WFI Corp. in Los Angeles. It obtains offshore-banking licenses and then resells them.

WFI sells its licenses through newspaper ads (often in The Wall Street Journal). Jerome N. Schneider, owner of WFI, says he sold 30 Montserrat banks last year and expects to sell 30 to 35 this year. WFI charges $39,500 plus a $7,600 licensing fee. Mr. Schneider says his service is cutting through the red tape a prospective licensee would face.

Mr. Schneider used to sell banks on St. Vincent and has even written a book on how to set up and use a bank there. But lately he has been emphasizing Montserrat because of St. Vincent's growing banking notoriety.

AN IMPRESSIVE NAME

In its literature, WFI offers some not too subtle tips about the value of its banks. "The bank has an impressive name which sounds like a multimillion-dollar bank's name," says one letter. "This, of course, will attract depositors." A list of Montsrrat based banks formed by WFI include Chase Overseas, Midland Overseas, LaSalle Overseas and Morgan Overseas.

Mr. Schneider says that because of the "unfortunate" experiences involving use of St. Vincent banks by con men, WFI investigates all prospective purchasers, weeding out crooks. WFI's literature states that Montserrat requires that a purchaser "not have a past criminal record" and that he not have been involved in "past criminal activities."

None of WFI's promotional material, however, mentions that Mr. Schneider himself has a criminal record and spent some time in jail. According to court records in Los Angeles, Mr. Schneider pleaded guilty to grand theft, after being charged with stealing about $1 million in equipment from Pacific Telephone & Telegraph Co. In 1972, Mr. Schneider was sentenced to 60 days in jail and received three years' probation.

"You're not going to hold that against me, are you?" the 31-year-old Mr. Schneider asks. "That was just a childish mistake when I was a kid." He says that Montserrat authorities are aware of it and that "they understand." Besides, he says, he has had his earlier sentencing expunged from the record.

CAUSES OF THE PROBLEM

This flow of bogus paper is so large that enforcement agents in the Comptroller's office say it can only be guessed at, but they estimate that the volume is "in the hundreds of millions of dollars.". As they see it, the problem stems from the lack of effective offshore banking regulation and the inattention of U.S. bankers to regulations and practices that would flag questionable financial instruments.

Meanwhile, the poor reputation the Caribbean area is getting seems to be a matter of indifference to regulatory officials on the islands, according to U.S. authorities. On St. Vincent, which has become particularly notorious for its "shell banks," a spokeswoman for the St. Vincent Trust Authority, the regulatory agency, says she can't discuss banking. "We don't give information to anyone," she says.

Banking authorities in Montserrat wouldn't return calls asking about their regulatory practices.

An official at one major West Coast bank says that because of the reputation of those institutions, "we have a practice of having nothing to do with any bank in the West Indies."

A recent report prepared for the Ford Foundation on offshore banking states that the islands of the Caribbean have become "a playground for fraudulent and other criminal bank users." The report adds, "until there is a central bank with the trained personnel, new regulations and criminal intelligence exchange, there is no question that the buccaneers' forays into banking, as in St. Vincent and Montserrat . . . will continue. Once established on a Caribbean isle, the pirates are difficult to dislodge."

TWO OF THE "PIRATES"

Two of the most famous of these "pirates" are Harold Goldstein, 35, and Kevin Krown, 38. Mr. Goldstein, a fugitive from arrest warrants issued by both the Los Angeles and the San Diego district attorneys' offices, in one month late last year stuck Los Angeles banks with about $2 million in worthless checks drawn on a shell bank he owned in Montserrat, according to an indictment on file in a California state court.

Kevin Krown, a former civil-rights activist and speech writer for the late Sen. Hubert Humphrey, was convicted this month in federal court in New York, along with six associates, on 50 counts of fraudulently relieving victims of their cash by issuing worthless letters of credit, certificates of deposit and other bogus instruments from phony offshore banks they controlled.

Mr. Goldstein is a comparative newcomer to offshore banking although he has plenty of experience in commodities swindling which earned him prison sentences in 1973 and 1976. Currently, in two unrelated cases he has been charged in a federal court in Los Angeles with another commodities scam, and the district attorney there also had him indicted on charges of possessing stolen securities.

NO COMMENT

The district attorney also charged Mr. Goldstein, along with an associate, with grand theft in connection with his City Overseas Bank of Montserrat. Mr. Goldstein's lawyer says neither he nor his client has any comment to make about any of the allegations.

Chairman ROTH. Mr. Serino, are there any legitimate uses of offshore brass plate banks, shell banks, whatever you want to call them?

Mr. SERINO. Mr. Chairman, there are legitimate uses being made by major institutions of licenses in the offshore jurisdictions. However, those banks, as I indicated in my statement, are well capitalized institutions and they are being used in the Euro markets and for competing with foreign countries.

Our concern is the ones we see that are just shells. They are not institutions that are fully capitalized and they are not institutions that have any semblance of reality other than the fact they have a license.

Chairman ROTH. Aren't most of those located in major financial centers, like Singapore, Hong Kong?

Mr. SERINO. That is correct, Mr. Chairman.

Although several U.S. banks have branches and subsidiaries, for instance, in the Cayman Islands, which they use for booking offices for the international market.

You are absolutely correct, most of them are in the major financial areas.

That is right.

Chairman ROTH. We have a number of firms and individuals going around the country acting as banking brokers, trying to sell banks, offshore banks.

Have you given any thought, should we regulate their activities? These individuals are within the authority of our laws of our courts. Should they be permitted to go around as they are now trying to sell these banks?

Let me just point out some of the statements they are making as they try to do this. This is one by "Using offshore banks and tax havens for profit, privacy and protection."

"The Offshore Finance Institute sponsors Jerome Schneider in an all new one day seminar."

They list all these interesting things you are going to learn. "Privacy in U.S. banks, who is exposed, who can get records, when and how, your right with your banks, how to use U.S. banks and still remain confidential."

It is pretty obvious what they are trying to sell. It is interesting, it says, "Attendees will be known to others on a first-name basis only. Registrants' affiliation will be checked to be certain they are bona fide investors and business persons. No news reporters or investigators will be admitted."

[The material referred to follows:]

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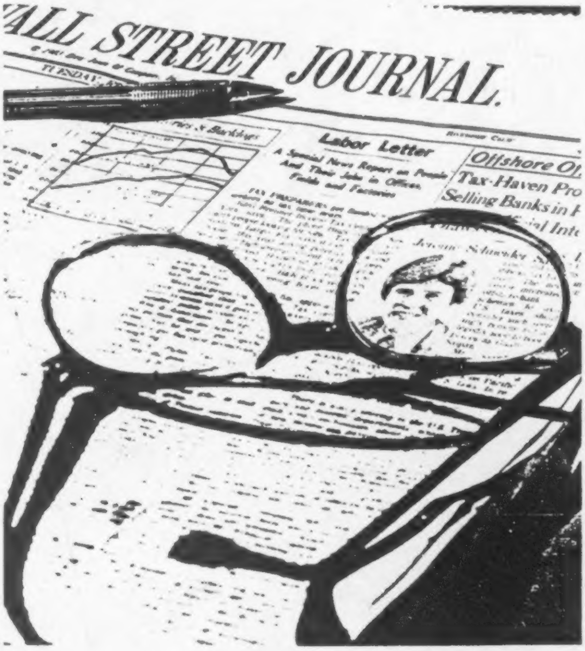

Jerome Schneider, Seminar originator and leading expert on offshore banking and tax havens. His knowledge, techniques and experiences have helped investors, businessmen and entrepreneurs make, save and protect fortunes. Mr. Schneider has written two best-selling books on offshore banking. He is a frequent guest lecturer at major financial conferences . . . and was featured in the two front page *Wall Street Journal* articles, crediting him as author and educator of the art of offshore banking.

You are invited to join Jerome Schneider and two other top offshore banking experts and learn in small-group sessions the knowledge and techniques needed to profit — *In Privacy* — using offshore banks and tax havens today.

Meet These Offshore Banking Experts Close-Up and Pick Their Brains . . .

Jerome Schneider
President, WFI Corporation

Mr. Schneider's firm is regarded as the foremost offshore banking consultation firm in America. WFI Corporation has, over the past eight years, advised or assisted in the establishment of over 900 separate offshore banks. Mr. Schneider is a frequent guest and lecturer on TV and at major financial conferences. He is author of USING AN OFFSHORE BANK FOR PROFIT, PRIVACY AND TAX PROTECTION, the definitive book on offshore banking today.

William K. Norman
International Tax and Securities Attorney

Mr. Norman is chairman of the International Business Department of the Los Angeles Office of Finley, Kumble, Wagner, Heine, Underberg & Manley. His specialty is foreign tax planning with emphasis on offshore banking. His clients include many medium to large corporations.

Robert G. Buchsbaum
Executive Director, WFI Corporation

Mr. Buchsbaum is a corporate development and planning specialist in offshore banking. His experience includes the long term financial planning for several major corporations. He holds a B.A. from the University of Pennsylvania and an M.B.A. in finance from the University of California at Los Angeles.

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If you would like the comfort and privacy of a one-to-one private consultation to discuss your particular personal or business needs, we recommend scheduling a private consultation.

Consultation will be scheduled on a first come, first serve basis with . . .

- Jerome Schneider, President, WFI Corporation
- William K. Norman, International Tax and Securities Attorney
- Robert Buchsbaum, Executive Director, WFI Corporation

You'll Receive Answers to Hundreds of Questions Like These . . .

"What's the attitude of the IRS toward legal use of tax havens?"

"Will my chances of an IRS audit increase?"

"How can I be sure there's nothing illegal in using or owning an offshore bank?"

"What's the difference between tax evasion and tax avoidance?"

"How do I move my money in and out of the U.S. without penalties?"

"How safe is it to deposit money in an offshore bank?"

"How do offshore banking secrecy laws protect me? Is it true my assets are totally impenetrable?"

"What is a controlled foreign corporation? How can I avoid this status?"

"How do I go about getting a group bank?"

"How do I buy real estate in the U.S. through an offshore bank?"

"Is it possible to legally avoid reporting requirements?"

"Can an offshore bank legally be used to provide insurance and trust services?"

"I've heard Swiss banks are no longer the best place to put my money. Why?"

"I've no banking experience—how can I successfully operate my own offshore bank?"

"What's the least expensive way I can acquire my own tax haven corporation?"

"Which offshore banking locales are recognized by major U.S. banks?"

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Attendees will be known to others on a first name basis only — registrants affiliations will be checked to be certain they are bona fide investors or businesspersons. No news reporters or investigators will be admitted.

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To provide you with a concise overview of the benefits, considerations and problems of using offshore banks and tax havens today.

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Introduction to Using Offshore Banks and Tax Havens

- History and growth
- Concepts and definitions
- Basic framework, structures and components
- Major problem areas and practical solutions

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- Obtaining highest interest on deposits
- Offshore mutual funds
- Investing in foreign currencies
- Self-insurance through offshore captives
- Bank float
- Ways to profit from owning an offshore bank

Assuring Financial Privacy Through Offshore Planning

- Understanding what is vulnerable
- The feasibility of fool-proof confidentiality
- Who are the privacy invaders?
- Can you legally hide information from the IRS?
- Setting privacy goals
- Techniques to obtain one's goals

Asset Protection: How to Make Your Assets Legally Judgment-proof

- Situations that permit asset protection
- Overview of techniques that make assets seizure-proof
- Major problems and suggested solutions
- How to "buy time" to build assets and negotiate

How to Use Offshore Banks and Tax Havens to Reduce U.S. Taxes

- The "basics" of offshore tax planning
- The major problems inhibiting tax protection
- The techniques and methods to overcome problems
- Typical tax advantaged business structures
- Special benefits for offshore banks

Current Comparisons of Bank Secrecy, Stability, Operating Costs, Communications, Air Connections, Tax Status, Reputation, and Special Problems and Benefits in . . .

- Anguilla, Bahamas, Bermuda, Cayman Islands, Channel Islands, Hong Kong, Netherland Antilles, Panama, Mariana Islands, Switzerland and Turks and Caicos

Procedures for Establishing a Tax Haven Corporation or Offshore Bank

- Where to start
- Selecting jurisdiction
- Getting connected
- Corporations: articles, minutes, directors, accounts
- Offshore Banks: license, management, paid-in capital
- Timing, references, pitfalls, and island visits
- Methods to save money

SPECIAL SEMINAR FEATURE

CBS "60 Minutes: THE CASTLE BANK CAPER"

In 1974, the IRS initiated "Project Haven" — an undercover effort to find and identify Americans who maintained accounts at Castle Bank and Trust in the Bahamas. The IRS's strategy: hire an operative, Norm Casper, who hired a prostitute, Sybil Kennedy, to lure the manager of Castle Bank, Mike Wossencroft, into permitting Kennedy to roam around Castle's office. This permitted her to steal the rolodex containing the name of the bank's customers. The rolodex was then handed over to the IRS. 60 Minutes' segment illustrates the vulnerability of only depending on bank secrecy laws as a basis for not reporting foreign bank accounts on your tax return. Commentary by Jerome Schneider following the segment coupled with questions and answers.

Custom Designed Workshops Methods First — Then Application To Your Situation . . .

The format of each workshop will be designed to provide usable information and knowledge applicable to the specific needs of individual attendees. The first half of each session will present the methods and techniques. At the mid point, questionnaires will be distributed asking for your *specific interest* and *specific needs.* The second part of the workshop will apply the methods and techniques learned from part 1 to your specific situation.

2A New Profit Strategies for Offshore Banks

Half-day Workshop No. 2-A Thursday 9 a.m. - 1 p.m.

April 14, April 21 and May 5

Workshop's Purpose

Provides attendee with the latest and most advanced techniques and blue prints to make or save money through being either a customer or owner of an offshore bank.

Who Should Attend

An absolute must for those considering owning their own offshore bank. Fairly advanced topics so prior offshore banking or tax haven knowledge will be helpful. If you are a beginner, seminar No. 1-A is recommended first.

Workshop Topics

Introduction to Profit Planning

- Understanding basic concepts
- Basic profit-making and cost saving techniques
- Laying groundwork for new strategies

Logistics Involved in Operating Offshore Banks

- Basic components
- Administration
- Management
- Custodians
- Other facilities

Marketing Offshore Banking Services

- Fundamentals
- Advertising
- Direct mail
- Referrals and broker networks

Using Computers to Automate Offshore Operations

- Fundamentals
- Telex relays
- Networks
- The future

Profit Strategies for Offshore Banks

- Case histories
- High interest offshore bank accounts
- Check float
- Letters of credit
- Lending above usury limits
- Blocked currency conversion
- Insurance
- Secret numbered bank accounts
- Trust services
- Custodian
- Interbank loans
- Wholesale banking

Attendee Submitted Topics and Discussion

2B Advanced Techniques for Obtaining Financial Privacy and Asset Protection

Half-day Workshop No. 2-B Thursday 2 p.m. - 6 p.m.

April 14, April 21 and May 5

Workshop Purpose

Presents in practical and usable terms the techniques that assure your financial privacy and assets are protected.

Who Should Attend

Privacy enthusiasts, private investors concerned about prying eyes, freedom seekers who dislike big brother, doctors who are prone to large malpractice lawsuits.

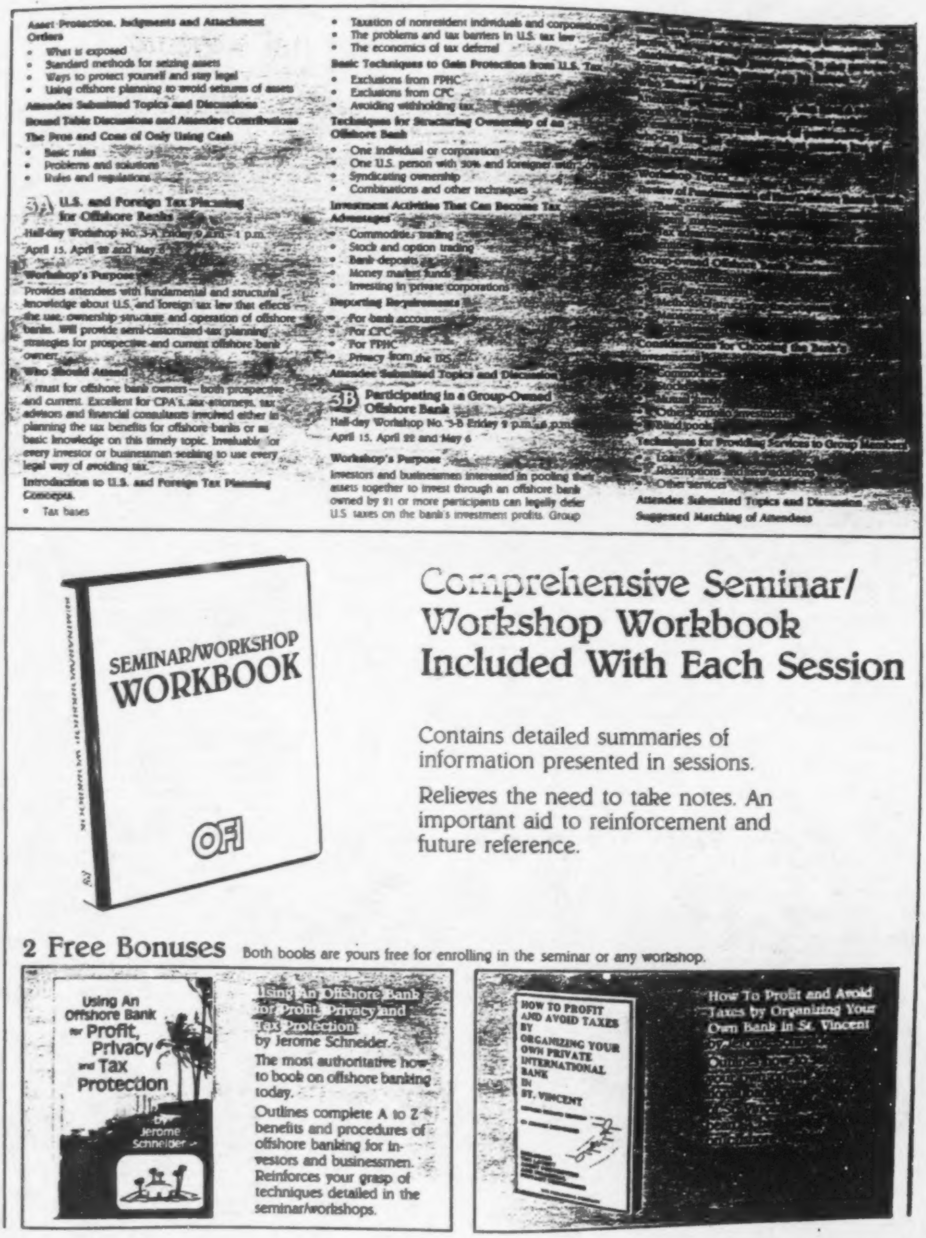
Workshop Topics

Understanding Financial Privacy and Asset Protection

- Basic concepts
- What is vulnerable
- Techniques that protect vulnerabilities
- What is legal

Privacy and U.S. Banks

- What is exposed
- Who can get records—when and how
- Your rights with your bank
- How to use U.S. banks and still remain confidential



Asset Protection, Judgments and Attachment Orders

- What is exposed
- Standard methods for seizing assets
- Ways to protect yourself and stay legal
- Using offshore planning to avoid seizures of assets

Attendee Submitted Topics and Discussions

Round Table Discussions and Attendee Contributions

The Pros and Cons of Only Using Cash

- Basic rules
- Problems and solutions
- Rules and regulations

3A U.S. and Foreign Tax Planning for Offshore Banks

Half-day Workshop No. 3-A Friday 9 a.m.–1 p.m.

April 15, April 22 and May 6

Workshop's Purpose

Provides attendees with fundamental and structural knowledge about U.S. and foreign tax law that effects the use, ownership structure and operation of offshore banks. Will provide semi-customized tax planning strategies for prospective and current offshore bank owners.

Who Should Attend

A must for offshore bank owners — both prospective and current. Excellent for CPA's, tax attorneys, tax advisors and financial consultants involved either in planning the tax benefits for offshore banks or as basic knowledge on this timely topic. Invaluable for every investor or businessman seeking to use every legal way of avoiding tax.

Introduction to U.S. and Foreign Tax Planning Concepts.

- Tax bases
- Taxation of nonresident individuals and corporations
- The problems and tax barriers in U.S. tax law
- The economics of tax deferral

Basic Techniques to Gain Protection from U.S. Tax

- Exclusions from FPHC
- Exclusions from CFC
- Avoiding withholding tax

Techniques for Structuring Ownership of an Offshore Bank

- One individual or corporation
- One U.S. person with 50% and foreigner with [illegible]
- Syndicating ownership
- Combinations and other techniques

Investment Activities That Can Become Tax Advantages

- Commodities trading
- Stock and option trading
- Bank deposits
- Money market funds
- Investing in private corporations

Reporting Requirements

- For bank accounts
- For CFC
- For FPHC
- Privacy from the IRS

Attendee Submitted Topics and Discussion

3B Participating in a Group-Owned Offshore Bank

Half-day Workshop No. 3-B Friday 2 p.m.–6 p.m.

April 15, April 22 and May 6

Workshop's Purpose

Investors and businessmen interested in pooling their assets together to invest through an offshore bank owned by 21 or more participants can legally defer U.S. taxes on the bank's investment profits. Group [illegible]

[illegible]

Workshop Topics

Review of [illegible]

[illegible]

Group-owned Offshore Bank [illegible]

[illegible]

Considerations for Choosing the Bank's Investments

- Commodities
- Stock
- Money funds
- Other portfolio investments
- Blind pools

Techniques for Providing Services to Group Members

- Loans [illegible]
- Redemptions and new additions
- Other services

Attendee Submitted Topics and Discussion

Suggested Matching of Attendees

Comprehensive Seminar/ Workshop Workbook Included With Each Session

Contains detailed summaries of information presented in sessions.

Relieves the need to take notes. An important aid to reinforcement and future reference.

2 Free Bonuses

Both books are yours free for enrolling in the seminar or any workshop.

Using An Offshore Bank for Profit, Privacy and Tax Protection
by Jerome Schneider

Using An Offshore Bank for Profit, Privacy and Tax Protection by Jerome Schneider.

The most authoritative how-to book on offshore banking today.

Outlines complete A to Z benefits and procedures of offshore banking for investors and businessmen. Reinforces your grasp of techniques detailed in the seminar/workshops.

HOW TO PROFIT AND AVOID TAXES BY ORGANIZING YOUR OWN PRIVATE INTERNATIONAL BANK IN ST. VINCENT

How To Profit and Avoid Taxes by Organizing Your Own Bank in St. Vincent by [illegible]

[illegible]

Using Offshore Banks and Tax Havens For Profit, Privacy and Protection

Seminar/Workshops Registration Information

Mail the registration form below or call now, toll-free (800) 252-0136 . . . (800) 421-4177 outside California or (213) 553-6758. Each session is strictly limited to 25 so we suggest you call or send in your registration now to be sure of a seat.

Seminar/Workshop Fees

Seminar: "Using Offshore Bank and Tax Havens for Profit, Privacy and Protection" session No. 1-A is $180. Fee includes cost of session, loose-leaf seminar workbook over 100 pages, Jerome Schneider's two best-selling books on offshore banking, morning and afternoon refreshments and complimentary open bar at the end of the day. Lunch not included but available conveniently nearby.

Workshops: Sessions No. 2-A, 2-B, 3-A and 3-B are $100 each per person for the first one and $75 each per person for additional workshops. Fee includes same extras as seminar if not already received for seminar registration.

Cancellations, Transfers and Substitutions: Registration fees are fully refundable if cancellation notice is received in our office up to 7 days prior to seminar or any workshop. Otherwise fees are transferable to any future OFI seminar or workshop or may be applied to the purchase of OFI books, videotapes or cassettes. Substitutions may be made at any time provided seating space is available.

General: All seminar/workshop fees must be paid in advance of any session. *No registration will be accepted at the door.* To reduce processing time and to speed your confirmation letter, please enclose your check or credit card information along with your registration form.

Private Consultation

Private 1 hour consultations will be confirmed on a first come, first served basis at $75. Cancellations may be made subject to terms above, however, no refunds or credit allowed for no shows.

Tax Deduction

An income tax deduction is allowed for educational expenses (including registration and consultation fees, travel, meals, lodging) undertaken to maintain and improve professional skills (See Treasury Regulation [illegible] or Coughlin vs. Commissioner 203 F 2d 307).

Seminar/Workshops Location

All seminar/workshops will be presented in the conference classroom of the Offshore Finance Institute located at 2049 Century Park East, Suite 2085, Los Angeles, California 90067. If you are coming from out of the Los Angeles area, we recommend you stay overnight at the Century Plaza Hotel, which is within walking distance to the meeting site.

Sessions	Dates		
Using Offshore Banks and Tax Havens For Profit, Privacy and Protection — No. 1-A	Wednesday April 13 9 am - 5 pm	Wednesday April 20 9 am - 5 pm	Wednesday May 4 9 am - 5 pm
New Profit Strategies for Offshore Banks — No. 2-A	Thursday April 14 9 am - 1 pm	Thursday April 21 9 am - 1 pm	Thursday May 5 9 am - 1 pm
Advanced Techniques for Obtaining Financial Privacy and Asset Protection — No. 2-B	Thursday April 14 2 pm - 6 pm	Thursday April 21 2 pm - 6 pm	Thursday May 5 2 pm - 6 pm
U.S. and Foreign Tax Planning for Offshore Banks — No. 3-A	Friday April 15 9 am - 1 pm	Friday April 22 9 am - 1 pm	Friday May 6 9 am - 1 pm
Participating in a Group-Owned Offshore Bank — No. 3-B	Friday April 15 2 pm - 6 pm	Friday April 22 2 pm - 6 pm	Friday May 6 2 pm - 6 pm

Mail This Registration Form to Reserve Space

Seating limited to 25 persons. For immediate confirmation, telephone now (800) 252-0106 . . . or toll-free (800) 421-4177 outside California or (213) 553-6758.

Mail to: **Offshore Finance Institute, Inc.**, 2049 Century Park East, Suite 2085, Los Angeles, CA 90067.

YES — Please register the names below for your 25 person seminar/workshops:

☐ **Using Offshore Banks and Tax Havens For Profit, Privacy and Protection.**
No. 1-A. Full-Day Seminar — Wednesday 9 am - 5 pm.
Check date you prefer ☐ April 13 ☐ April 20 ☐ May 4

☐ **New Profit Strategies Using Offshore Banks.**
No 2-A. ½-Day Workshop — Thursday, 9 am - 1 pm
Check date you prefer ☐ April 14 ☐ April 21 ☐ May 5

☐ **Advanced Techniques for Obtaining Financial Privacy and Asset Protection.**
No. 2-B. ½-Day Workshop — Thursday, 2 pm - 5 pm
Check date you prefer ☐ April 14 ☐ April 21 ☐ May 5

☐ **U.S. and Foreign Tax Planning for Offshore Banks.**
No. 3-A. ½-Day Workshop — Friday, 9 am - 1 pm
Check date you prefer ☐ April 15 ☐ April 22 ☐ May 6

☐ **Participating in a Group Owned Offshore Bank.**
No. 3-B. ½-Day Workshop — Friday, 2 pm - 5 pm
Check date you prefer ☐ April 15 ☐ April 22 ☐ May 6

My total number of workshops is ________ at $100 for the first, $75 per person each additional. Total $________

☐ I request individual private consultation with:
☐ Jerome Schneider ☐ William Norman ☐ Robert Buchsbaum

My total number of consultations is ________ at $75 each. Total $________

☐ Enclosed is my check payable to OFI, Inc.

☐ Bill my organization. Send invoice to the attention of ________
Payment will be made prior to the seminar/workshop.

☐ This is confirmation of telephone reservation — check enclosed.

☐ Please charge to: ☐ Visa ☐ Mastercard ☐ American Express

Card No ________ Exp. Date ________

Signature ________

Name ________
Name ________
Name ________
Company/Organization ________
Address ________
City ________ State ________ Zip ________
Phone ( ) ________

Please also send information on:

☐ On-Site seminar/workshops
☐ Videotape of past seminar
☐ Books on offshore banking and tax havens
☐ Seminar/workshop course books and cassettes for those who cannot attend
☐ Complete details on how to own my own offshore bank
☐ Future seminars and workshops

Important: Registrants please include your business card or letterhead. Reporters and investigators will not be admitted.

OFI
Offshore Finance Institute Inc.
2049 Century Park East, Suite 2085
Los Angeles, California 90067
(213) 553-6758

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3643 JENNIFER NA
WASHINGTON DC 20015

RUSH - DATED MATERIAL

Chairman Roth. Do you think it might be practical or realistic to regulate the activities of these individuals who are trying to sell offshore banks?

Might that be an approach?

Mr. Serino. I would love to see it happen, Mr. Chairman, but I don't know whether or not it is something that could be done. I know one of the other questions is whether or not we ought to license money brokers and many of these people going around representing that there are large sums of money available.

Certainly it is something we ought to look into. One of the major areas I suggest in my testimony is that we somehow convince the offshore jurisdictions that they create legislation themselves that will require various hoops to go through before they grant licenses.

I really don't think it is appropriate for an offshore jurisdiction, quite frankly, to grant licenses wholesale to one individual with the understanding that that individual will then go someplace else and sell them.

I don't know how the offshore jurisdiction can——

Chairman Roth. Can there be any legitimate purpose for that kind of a deal, that kind of approach? I suppose——

Mr. Serino. There may be one, Mr. Chairman, but I don't think I am aware of it right off the top of my head.

Chairman Roth. You see what bothers me, I agree with you it would be desirable to reach some kind of agreement with the foreign governments, with rules and regulations—international rules and regulations—that we could all agree upon. But the fact is that that has not been practical to date.

You are trying to do something in this area, but how much success are you having with these various countries?

Mr. Serino. We have been somewhat successful—the Comptroller's Office—in convincing certain jurisdictions that, hey, you are going to be better off if you start cleaning up your act.

As I indicated in my statement, we had one jurisdiction that reduced from 200 banks to 20 banks. That jurisdiction, when we first talked with them on the telephone—I will give you an example. We had indications that there were cashiers checks drawn on a bank licensed by this particular jurisdiction totaling about $5 million that were being passed in the United States.

They were going to be used to purchase some property. The information was brought to my attention and I immediately contacted the banking authority on the island.

I said, what can you tell me about this particular institution? And the authorities said, well, it is a reputable institution, it is run by a reputable individual.

I said, well, if in fact I told you I had checks totaling $5 million drawn on this institution, would you have much faith in them? She indicated, no.

The next thing I got, rather than her doing anything, was a call from somebody who represented themselves to be the owner of the institution. He criticized me—we spoke for about an hour on the telephone. He told me I was going to be creating an international incident by questioning the validity of his particular institution.

We had conversations like this over the next, I guess, several months, myself and the banking authority. I bring to their attention the problems. I talk to them about the problems and criticize them about the problem. Then finally Mr. Shockey from my staff went down and visited with her on two occasions. He met with her and convinced her that it would be to their best interest to clean up their act.

In fact, they did clean up their act, to the best of our knowledge. They have reduced the number of banks. They have passed legislation that supposedly requires the verification of capital, supposedly requires a review of the background of particular individuals.

It has worked. We are communicating with several jurisdictions. We are aware of several jurisdictions that have come to us and said, hey, can you help us with our legislation? We have supplied information on how they can modify their legislation.

Chairman ROTH. Can you advise us what jurisdictions are cooperating and which ones are not?

Mr. SERINO. I will be happy to look through our files and see how much cooperation we have from which ones, yes.

Chairman ROTH. I would be particularly interested in some of these trusteeships, what kind of cooperation we are securing from them?

Mr. SERINO. We have visited with some of them. We have proposed to them some legislation and we think they are very interested in the legislation that we have proposed to them.

Chairman ROTH. I would suggest that I believe in a number of instances we were very helpful in some of their budgetary problems. It seems to me they could be equally cooperative in this problem. I don't want to limit it to this group.

I believe that is all I have for the moment.

Senator Rudman.

Senator RUDMAN. I have two questions. Mr. Serino, does it seem strange to you that American financial institutions will accept large certified checks, certificates of deposit, and other instruments on banks from these jurisdictions knowing possible fraud can exist?

Mr. SERINO. Senator, that is the $84,000 question—$64,000 question as far as I am concerned. Why people or institutions accept these instruments without making verification boggles my mind. I don't understand it.

Senator RUDMAN. Let me make a suggestion to you that may or may not be practical. One of the principal types of fraud would be the issuance of very authentic looking documents that, in fact, have no backing whatsoever, such as this one from the American Overseas Bank Limited in Montserrat.

[Copy of the document referred to follows:]

American Overseas Bank Limited
Plymouth, Montserrat, West Indies

Place Date

IRREVOCABLE NEGOTIATION LETTER OF CREDIT	All drafts must be marked "Drawn under Bank credit no	Advising bank reference no
Advising bank	For account of	
To beneficiary	Amount Expiration date	

Gentlemen: ☐ This refers to preliminary cable advice of this credit.

We hereby establish our irrevocable letter of credit in your favor available by your drafts drawn at
on
and accompanied by documents specified below covering invoice value of merchandise to be described in invoice as:

Shipment from	to	
Shipment latest	Partial shipments ☐ Permitted ☐ Not permitted	Transshipment ☐ Permitted ☐ Not permitted

Documents must be presented to the negotiating or paying bank no later than days after date of shipping document (On Board validation applicable for ocean shipment) but prior to expiration date of this credit

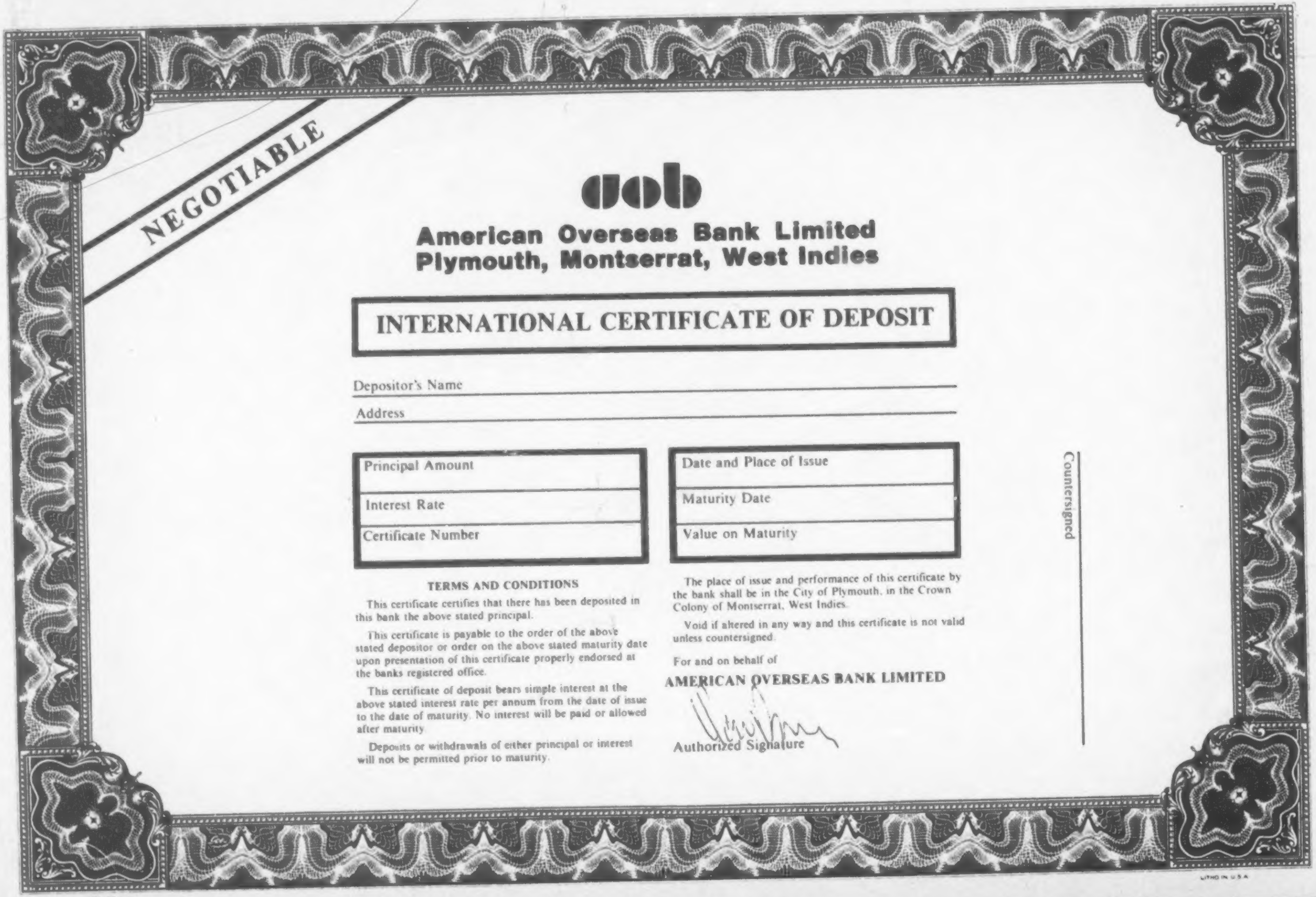
We hereby agree with bona fide holders that all drafts drawn under and in compliance with the terms of this credit shall meet with due honor upon presentation and delivery of documents as specified to the drawee if drawn and presented for negotiation on or before expiration date of this credit. The amount and date of each negotiation must be endorsed on the back hereof by the negotiating bank Negotiating bank charges are for account of beneficiary Sincerely yours Authorized counter signature Authorized signature	Advising bank's notification Place, date, name and signature of the advising bank

PROVISIONS APPLICABLE TO THIS CREDIT: "This credit is subject to the Uniform Customs and Practice for Documentary Credits (1974 Revision) International Chamber of Commerce, Publication No. 290"

Please examine this instrument carefully. If you are unable to comply with the terms or conditions, please communicate with your buyer to arrange for an amendment. This procedure will facilitate prompt handling when documents are presented

Senator **Rudman**. I guess if you are trying to close a real estate transaction with a bank some place they would accept that, although frankly I don't believe any New Hampshire banks would, there are those who might—this type of certificate is very official looking.

[Copy of the document referred to follows:]



NEGOTIABLE

American Overseas Bank Limited
Plymouth, Montserrat, West Indies

INTERNATIONAL CERTIFICATE OF DEPOSIT

Depositor's Name

Address

Principal Amount

Interest Rate

Certificate Number

Date and Place of Issue

Maturity Date

Value on Maturity

TERMS AND CONDITIONS

This certificate certifies that there has been deposited in this bank the above stated principal.

This certificate is payable to the order of the above stated depositor or order on the above stated maturity date upon presentation of this certificate properly endorsed at the banks registered office.

This certificate of deposit bears simple interest at the above stated interest rate per annum from the date of issue to the date of maturity. No interest will be paid or allowed after maturity.

Deposits or withdrawals of either principal or interest will not be permitted prior to maturity.

The place of issue and performance of this certificate by the bank shall be in the City of Plymouth, in the Crown Colony of Montserrat, West Indies.

Void if altered in any way and this certificate is not valid unless countersigned.

For and on behalf of
AMERICAN OVERSEAS BANK LIMITED

Authorized Signature

Countersigned

Senator RUDMAN. What would happen for regulation or law if we enacted a law or promulgated a regulation which stated that any transaction in excess of—you can pick any number you want—probably I would say $50,000 or whatever, from any foreign bank could not be honored in any American institution, unless that bank had on file with your office a certificate of capitalization of, let's say, a substantial amount, let's say $10 million. In that event the transaction would have to be consummated through the American correspondent bank. A legitimate bank would have an American correspondent bank.

In other words, what would happen if you protect the depositors by starting to put some restrictions on how this paper can be used?

Mr. SERINO. Senator Rudman, I think some restrictions are appropriate. I don't know whether or not that particular one is the one to suggest. It certainly is one to think about. I just don't know the answer.

Senator RUDMAN. It certainly would be a matter of very little work, indeed, for all of the legitimate institutions worldwide, including offshore banks that are legitimate, to quickly register under that sort of regulation to make that paper transferable. I would think Congress would have the right to pass such a statute. I think perhaps under your enabling legislation you may well be able to promulgate protective regulations. Essentially what you are talking about is defrauding banks and thus the securities of the stockholders and depositors. It seems to me we have to protect some of these people from their own stupidity.

I know as one who practiced law, there is no way I would accept this kind of a certificate at a closing representing a bank or somebody else. I would say fine, have them get in touch with their New York, San Francisco, or Washington correspondent bank and give us the paper from that bank. Evidently a lot of people are not doing that Maybe we ought to find a way to impair their viability by impairing the way they do business.

It is something you might look into.

Mr. SERINO. Thank you.

We have seen examples where they accept the document for collection. One instance was I think a $2 million check. Unfortunately while accepting that for collection they gave them an advance of $150,000. There are those kinds of problems. Why it happened, I just don't know.

Chairman ROTH. Thank you, Mr. Serino.

We will look forward to your supplying the additional information and work with you on that. That will be all.

At this time we will call upon the staff, Mr. Tom Karol and Chuck Morley. Please stand and raise your right hands.

Do you swear the testimony you will give before this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God.

Mr. MORLEY. I do.

Mr. KAROL. I do.

Chairman ROTH. Please proceed.

TESTIMONY OF CHUCK MORLEY, CHIEF INVESTIGATOR; AND TOM KAROL, STAFF COUNSEL; SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. MORLEY. Thank you, Mr. Chairman.

Mr. Chairman, I would like to take a few short minutes to summarize our staff statement and I would ask the full statement be entered into the record.[1]

Chairman ROTH. Without objection.

Mr. MORLEY. As you are aware for the last 2 years, the subcommittee has been investigating offshore banking and one of the areas that has become of significant concern to us has been the brokering of brass plate offshore banks. We have found in looking at this phenomenon that numerous jurisdiction have very lax controls or controls that are easily circumvented. We are not concerned today with the legitimate offshore brass plate banks that are owned by large corporations.

I might say the legitimate use of brass plate banks is very significant and very important to international finance. However, the legitimate uses we have found have been almost the exclusive realm of large corporate offshore banks or brass plate banks of large U.S. multinational banks.

As Mr. Serino mentioned, these banks traditionally exist in large international financial centers, such as Cayman Islands, Panama, Hong Kong, and Bahamas. Those types of institutions are not of concern to us in this investigation. We are concerned with institutions that exist in other centers, such as Anguilla, Montserrat, the Mariana Islands, and St. Vincent.

We have found that the legitimate use of brass plate banks requires two significant criteria. No. 1 is an extremely large capital base, from which to operate. No. 2 is extensive experience in banking and an understanding of international finance and banking.

During this phase, we attempted to determine why so many people were purchasing banks in the, shall we say, nonfinancial centers, centers such as the Marianas, Monteserrat, St. Vincent, that do not require a large capital base nor do they require banking experience.

Given that these two items are necessary, we then wanted to contact the owners of these banks to see exactly why they were using the banks. Because of secrecy we were thwarted in this effort for the most part. However, we did learn of the WFI Corp., and we subpenaed their records in order to see if we could determine who they had sold banks to.

The records provided by the WFI Corp., revealed the existence of 77 banks which were owned by 60 different individuals. After extensive investigation, we were able to locate only half of the purchasers of these banks. Of those located, two-thirds claimed never to have used the banks purchased. Of the remaining, 20 percent would not speak to the subcommittee staff.

Chairman ROTH. Would you speak into the microphone, it is a little hard to hear.

Mr. MORLEY. Of the remaining, 20 percent would not speak to the subcommittee, two were found to be agents of others and had no idea what the banks were being used for and most importantly, the remaining two were the only two found by the subcommittee to have arguably made legitimate use of these brass plate banks.

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[1] See p. 370 for the staffs prepared statement.

Chairman ROTH. Two out of how many?

Mr. MORLEY. Out of 31, I believe, that we actually contacted, that we could contact. That is 2 out of 77 that we originally looked at. I might say the records reviewed by the subcommittee staff did not include the private banks sold by WFI Corp. in the Northern Marianas.

WFI today provided us with additional subpenaed documents. These documents are here and we will review them as soon as we can get to them. I would ask that the record remain open so that we can introduce documents we feel are relevant.

Chairman ROTH. So ordered.

[The material referred to was marked "Exhibit No. 17," for reference, and remains in the confidential files of the subcommittee.]

[The data is summarized as follows:]

WFI CORPORATION
OFFSHORE COMPANIES AND BANKS PURCHASED AND SOLD AS OF MAY 20, 1983

Anguilla Banks
Cayman Companies
Mariana Islands Banks
Marshall Islands Banks
Montserrat Banks
Panamanian Companies
St. Vincent Companies
St. Vincent Banks
Vanuatu Banks

ST. VINCENT OFFSHORE BANKS

Barron's Bank and Trust Company Limited
Bishops Bank and Trust Company Limited
Caribancorp Limited
Co-Op Investment Company Limited
European Overseas Bank Limited
First National Bank of North American Limited
International Commonwealth Bank and Trust Co. Ltd.
Lord's Bank and Trust Company Limited
Noble Bank and Trust Company Ltd.
Northwest International Bank and Trust Co. Ltd.
Petrochemical Int'l Bank and Trust Co. Ltd.
Regency International Bank Limited
Wellington Int'l Bank and Trust Co. Ltd.

ANGUILLA OFFSHORE BANKS

American Commerce Bank and Trust Co. Ltd
American Fidelity Bank and Trust Co.
American International Bank and Trust Co. (WI) Ltd.
American Security Bank (WI) Limited
Banque Peregrine (WI) Limited
Caribbean Bank and Trust Company Limited
Co-Op International Bank (WI) Limited
Overseas Monetary Bank (WFI) Limited
Pacific International Bank and Trust Company
Union Bank and Trust Company (WI) Limited
Union Chartered Bank (WI) Limited
Union Commerce Bank (WI) Limited
World Security Int'l Bank & Trust Co. (WI) Ltd.

MONTSERRAT OFFSHORE BANKS

American Bank of Commerce Limited
American International Bank Limited

Page 2

American Overseas Bank Limited
Caribbean International Bank Limited
Caribbean Overseas Bank Limited
Carlton International Bank Limited
Century Overseas Bank Limited
Chase Overseas Bank Limited
City International Bank Limited
Colonial International Bank Limited
Colonial Overseas Bank Limited
Commonwealth International Bank Limited
Dominic Overseas Bank Limited
European International Bank Limited
European Overseas Bank Limited
Fidelity International Bank Limited
Foreign Commerce Bank Limited
Gibraltar International Bank Limited
Global Chartered Bank Limited
Handelsbank von Montserrat Limited
Harvard Overseas Bank Limited
Heritage International Bank Limited
Intercontinental Bank Limited
Intercontinental Bank of Commerce Limited
International Overseas Bank Limited
Investors International Bank Limited
J. David Banking Company Limited
La Salle Overseas Bank Limited
Manhattan International Bank Limited
Manufacturers Overseas Bank Limited
Merchants International Bank Limited
Metropolitan Overseas Bank Limited
Midland International Bank Limited
Morgan Overseas Bank Limited
North American Bank of Commerce Limited
North American International Bank Limited
North American Overseas Bank Limited
Pan American International Bank Limited
Regency International Bank Limited
Republic International Bank Limited
Security International Bank Limited
Security Overseas Bank Limited
Sterling Overseas Bank Limited
Surety International Bank Limited
Swiss European Bank Limited
Swiss International Bank Limited
Swiss Overseas Bank Limited
Union Chartered Bank Limited
Union International Bank Limited
United Bank of Commerce Limited
United International Bank Limited
United Overseas Bank Limited
Western Overseas Bank Limited

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World Chinese Trust Bank Limited

PANAMANIAN OFFSHORE CORPORATIONS

Blue Developments S.A.
Caribbean Overseas Holdings S.A.
Montserrat Financial Holding S.A.
Montserrat Overseas Holdings S.A.
North American Overseas Holdings S.A.
Pacific Funding Group S.A.
Pacific Investment Fund S.A.
Trans United Corporation

CAYMAN ISLANDS CORPORATIONS

American Atlantic Investment Company
American North Investment Company
American Pacific Investment Company
American Thrift and Loan Association Ltd.
Canbist Associates Limited
Colonial Chartered Investment Company Limited
Concourse Management Limited
Dril Tec International Inc.
European Holding Investment Company
Europlacements Ltd.
Hawaiian Financial Corporation
Melanie Holdings Limited
OMNI World Limited
Sunshine Investment Group Inc.
Union Thrift and Loan Association Inc.
Universal Research Laboratories, Inc.
Western Investment Corporation
World Security Financial Corporation Ltd.

MARIANA ISLANDS OFFSHORE BANKS

American Bank and Trust Company Limited
American Chartered Bank Limited
American Commerce Bank Limited
Asian Commerce Bank Limited
Asian Credit Bank Limited
Colonial Bank of Commerce Limited
Colonial Chartered Bank Limited
Commercial Bank and Trust Company Limited
Commercial Bank of Commerce Limited
Commercial Chartered Bank Limited
Commercial Credit Bank Limited
Continental Bank and Trust Company Limited
Continental Bank of Commerce Limited
Continental Chartered Bank Limited
Dominion Bank of Commerce Limited

Dominion Chartered Bank Limited
Dominion Commerce Bank Limited
European Bank of Commerce Limited
European Credit Bank Limited
Fidelity Bank of Commerce Limited
Fidelity Chartered Bank Limited
First American Bank Limited
First Fidelity Bank Limited
First Global Bank Limited
First International Bank Limited
First North Western Bank Limited
First Pacific Bank Limited
First Republic Bank Limited
Gibraltar Bank of Commerce Limited
Gibraltar Chartered Bank Limited
Global Bank and Trust Company Limited
Global Bank of Commerce Limited
Global Credit Bank Limited
Heritage Bank and Trust Company Limited
Heritage Chartered Bank Limited
Merchants Bank of Commerce Limited
Merchants Credit Bank Limited
North American Bank and Trust Company
North American Chartered Bank Limited
North Western Bank of Commerce Limited
North Western Chartered Bank Limited
Pacific Bank and Trust Company Limited
Pacific Bank of Commerce Limited
Republic Bank and Trust Company Limited
Republic Bank of Commerce Limited
Republic Chartered Bank Limited
Royal Bank and Trust Company Limited
Royal Chartered Bank Limited
Royal Credit Bank Limited

MARSHALL ISLANDS OFFSHORE BANKS

American Bank of Commerce Limited
American Overseas Bank Limited
Colonial Bank and Trust Company
Commercial Overseas Bank Limited
Continental Overseas Bank Limited
Dominion Bank and Trust Company Limited
European Bank and Trust Company Limited
Fidelity Bank and Trust Company Limited
Fidelity Commerce Bank Limited
Fidelity International Bank Limited
First Colonial Bank Limited
First Commercial Bank Limited
First Continental Bank Limited
First Dominion Bank Limited

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First European Bank Limited
First Gibraltar Bank Limited
First Heritage Bank Limited
First International American Bank Limited
Gibraltar Bank and Trust Company Limited
Gibraltar International Bank Limited
Gibraltar Overseas Bank Limited
Global Chartered Bank Limited
Heritage International Bank Limited
Heritage Overseas Bank Limited
Merchants International Bank Limited

VANUATU OFFSHORE BANKS

Trans-Pacific International Bank Limited
Fidelity International Bank Limited

Mr. MORLEY. The Permanent Subcommittee on Investigations' interviews with bank owners who attempted to make legitimate use of their banks were illuminating. Many of the owners alleged that WFI Corp. had misrepresented the potential uses of brass plate banks. Some told the subcommittee that they were unable to open correspondent accounts with class A banks in the host countries or in the United States. Perhaps most significantly, they told the subcommittee that they were unable to make use of these banks as they had neither the extensive banking experience required nor the tremendous financial resources necessary to enter into the sophisticated and complex world of offshore banking.

During this phase of our investigation, the subcommittee attempted to determine how many private banks exist and in what jurisdictions, who owns these banks and how these banks were being legitimately used. Because of strict secrecy laws, we have met with little success. We have determined that the illegal uses abound and that legitimate uses are extremely limited.

The total number of private banks in existence, the number owned by Americans and how many are being used legally or illegally remains largely unknown.

Again, Mr. Chairman, we have found that viable use of offshore banks requires significant capitalization, yet many havens are extremely lax in capitalization requirements. During our investigation, we uncovered what might be perhaps a classic example of this situation. At this point staff counsel, Thomas Karol, will explain to you how a local firm formed two offshore banks with such questionable capitalization.

Mr. KAROL. Mr. Chairman, we found in our investigation a local entity, Co-op Investment Bankers of Rockville, Md., here after referred to as Co-op/Maryland, a mortgage banker licensed by the State of Maryland is involved in offshore banking.

We contacted the officers of Co-op/Maryland, Aleksandrs Laurins and Charlene Baden, but both were uncooperative and refused to provide the subcommittee with any useful information.

[Letter from Charlene Baden, dated May 19, 1983 follows:]

MAY 19, 1983.

S. CASS WEILAND,
Chief Counsel, Committee on Governmental Affairs, Washington, D.C.

DEAR MR. WEILAND, I have no desire to discuss anything with your committee. My willingness or unwillingness to testify is not an issue.

Sincerely,

CHARLENE BADEN.

Mr. KAROL. The subcommittee therefore subpenaed Co-op's records from the National Savings & Trust Co. in Washington, D.C.—the NS&T Bank. These records showed that Laurins and Baden, through Co-op/Maryland, established an NS&T bank account for Co-op Investment Bank, Ltd.—hereafter referred to as Co-op/St. Vincent—and agreed to provide the capital for the St. Vincent's bank. To provide this capital they passed large checks between two accounts with small balances. The large checks canceled each other out.

Apparently the only purpose was to generate a large deposit ticket to be used as evidence of capitalization. The Co-op/St. Vincent's deposit ticket was sent by Laurins to broker Jerome Schneider, of WFI, and then to the Government of St. Vincent as proof of sufficient capitalization. A license was then granted by that government to operate the Co-op/St. Vincent's bank.

Chairman ROTH. Let me make sure I understand what you are talking about. You are saying at the same time they drew two checks on two different deposits in the same banks.

Mr. KAROL. That is correct.

Chairman ROTH. So it was a wash, is that what you are saying?

Mr. KAROL. Yes, it was, Mr. Chairman.

Chairman ROTH. What was the purpose of that?

Mr. KAROL. We asked the managing director and vice president of the NS&T Bank if there could be any purpose for this. He said the only result of this transaction was to generate a deposit ticket which inaccurately reflected deposits on deposit that day.

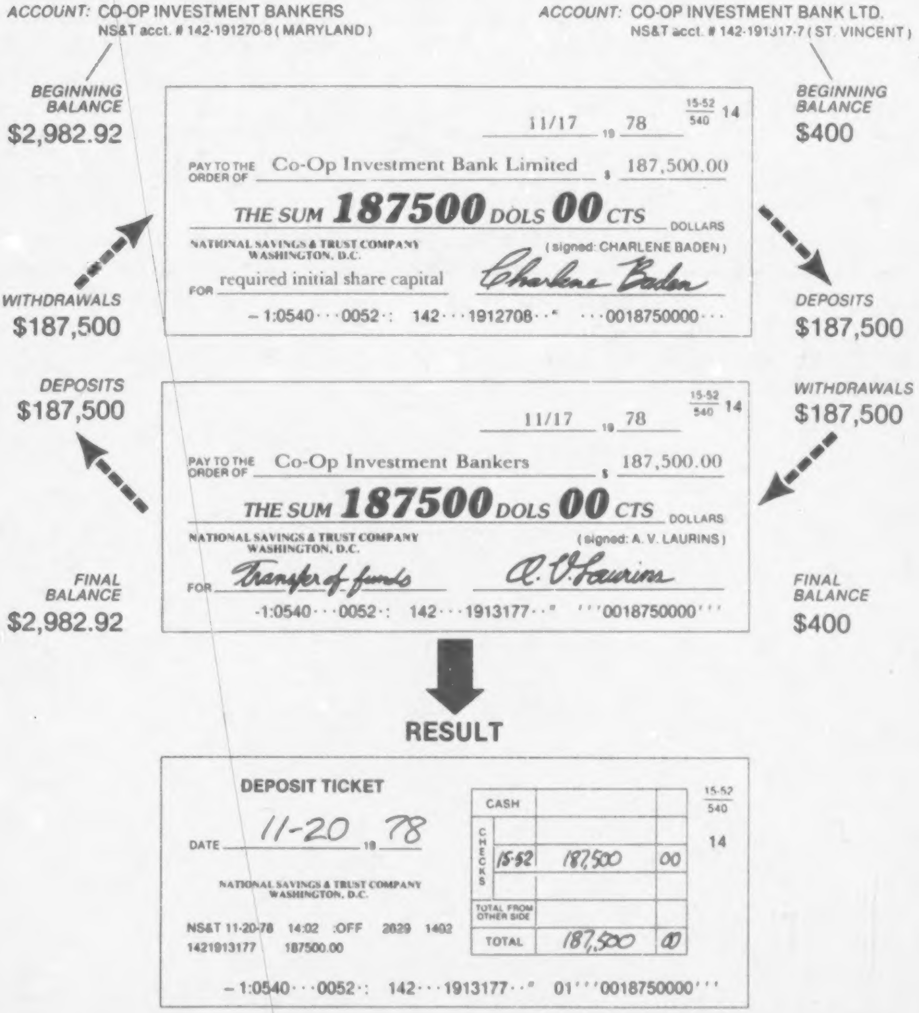
Chairman ROTH. In other words, to the extent there were any requirements of capital, it was a loophole or a way around, a fraud. Basically, there wasn't that capital; is that correct?

Mr. KAROL. That is correct, Mr. Chairman. The chart on my right clearly shows the Co-op Investments Bankers of Maryland, the column on the left had a beginning balance of less than $3,000. Yet on November 20, 1978, at exactly 2:02 p.m. Charlene Baden wrote a check for $187,500 which was deposited into the Co-op/St. Vincent's account. This was drawn on the Co-op Maryland account and signed by Charlene Baden.

[Copies of the checks referred to follow:]

ESTABLISHING AN OFFSHORE BANK IN ST. VINCENT

PAPER CAPITALIZATION, NOV. 20, 1978 2:02 PM



ACCOUNT: CO-OP INVESTMENT BANKERS
NS&T acct. # 142-191270-8 (MARYLAND)

BEGINNING BALANCE
$2,982.92

WITHDRAWALS
$187,500

DEPOSITS
$187,500

FINAL BALANCE
$2,982.92

ACCOUNT: CO-OP INVESTMENT BANK LTD.
NS&T acct. # 142-191317-7 (ST. VINCENT)

BEGINNING BALANCE
$400

DEPOSITS
$187,500

WITHDRAWALS
$187,500

FINAL BALANCE
$400

11/17 19 78 15-52/540 14

PAY TO THE ORDER OF Co-Op Investment Bank Limited $ 187,500.00

THE SUM **187500** DOLS **00** CTS DOLLARS

NATIONAL SAVINGS & TRUST COMPANY
WASHINGTON, D.C.

(signed: CHARLENE BADEN)

FOR required initial share capital Charlene Baden

– 1:0540 · · · 0052 · : 142 · · · 1912708 · · ″ · · · 0018750000 · · ·

11/17 19 78 15-52/540 14

PAY TO THE ORDER OF Co-Op Investment Bankers $ 187,500.00

THE SUM **187500** DOLS **00** CTS DOLLARS

NATIONAL SAVINGS & TRUST COMPANY
WASHINGTON, D.C.

(signed: A. V. LAURINS)

FOR Transfer of funds A. V. Laurins

-1:0540 · · · 0052 · : 142 · · · 1913177 · · ″ ′ ′ ′0018750000′ ′ ′

RESULT

DEPOSIT TICKET

DATE 11-20 19 78

15-52/540 14

NATIONAL SAVINGS & TRUST COMPANY
WASHINGTON, D.C.

NS&T 11-20-78 14:02 :OFF 2029 1402
1421913177 187500.00

CASH			
CHECKS			
	15-52	187,500	00
TOTAL FROM OTHER SIDE			
TOTAL		187,500	00

– 1:0540 · · · 0052 · : 142 · · · 1913177 · · ″ 01′ ′ ′0018750000′ ′ ′

THE DEPOSIT TICKET WAS SENT TO WFI, LOS ANGELES, ON NOVEMBER 21, 1978 BY A.V. LAURINS "SHOWING THAT U.S. $187, 500 HAS BEEN PAID IN AS CAPITAL FOR CO-OP INVESTMENT BANK" AT NS&T. LAURINS THEN DIRECTED WFI TO SO INFORM THE ST. VINCENT TRUST AUTHORITY.

Mr. KAROL. On the memo portion of the check it states, "required initial share of capital." At the same moment from the Co-op/St. Vincent's account, with deposits of only $400 that day, a second check for $187,500 was drawn and returned to the Co-op/Maryland account which resulted in the generation of another deposit ticket. The first deposit ticket and check was sent along with a letter from Mr. Laurins to Jerome Schneider of WFI, which I would like to read:

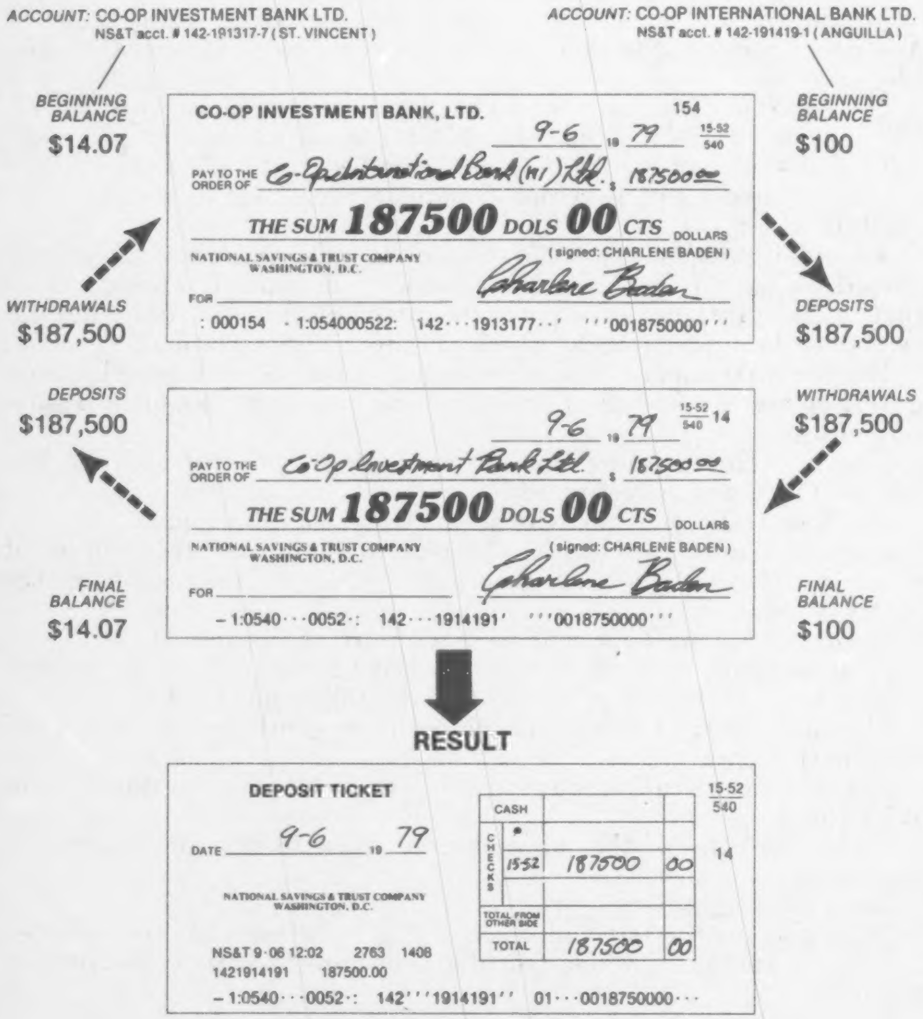
> Dear Jerry, enclosed herewith are copies of our resolution, check, and deposit slip showing that $187,500 has been paid in as capital for Co-op Investment Bank Ltd. to its organizational account at the National Savings and Trust Company.
>
> Please forward this information to the St. Vincent's Trust Authority and request they provide the new Bank with the letter acknowledging authorities to start the conduct of banking business.

A year later, Baden and Daurins, and Mr. Schneider as attorney-in-fact, applied for and received another offshore bank license in Anguilla. This same type of transaction took place again in 1979. On the chart to my right, you can see the check from the St. Vincent account for $187,500 was sent to the Anguilla bank account.

[Copies of the checks referred to follow:]

ESTABLISHING AN OFFSHORE BANK IN ANGUILLA

HISTORY REPEATS ITSELF, SEPT. 6, 1979 12:02 PM



ACCOUNT: CO-OP INVESTMENT BANK LTD.
NS&T acct. # 142-191317-7 (ST. VINCENT)

ACCOUNT: CO-OP INTERNATIONAL BANK LTD.
NS&T acct. # 142-191419-1 (ANGUILLA)

BEGINNING BALANCE $14.07

BEGINNING BALANCE $100

CO-OP INVESTMENT BANK, LTD. 154
9-6 19 79 15-52/540
PAY TO THE ORDER OF Co-Op International Bank (AI) Ltd. $ 187500.00
THE SUM 187500 DOLS 00 CTS DOLLARS
NATIONAL SAVINGS & TRUST COMPANY
WASHINGTON, D.C.
(signed: CHARLENE BADEN)
Charlene Baden
FOR
: 000154 · 1:054000522: 142· · ·1913177· ·' '''0018750000'''

WITHDRAWALS $187,500

DEPOSITS $187,500

DEPOSITS $187,500

WITHDRAWALS $187,500

9-6 19 79 15-52/540 14
PAY TO THE ORDER OF Co-Op Investment Bank Ltd. $ 187500.00
THE SUM 187500 DOLS 00 CTS DOLLARS
NATIONAL SAVINGS & TRUST COMPANY
WASHINGTON, D.C.
(signed: CHARLENE BADEN)
Charlene Baden
FOR
– 1:0540· · ·0052·: 142· · ·1914191' '''0018750000'''

FINAL BALANCE $14.07

FINAL BALANCE $100

RESULT

DEPOSIT TICKET
DATE 9-6 19 79
NATIONAL SAVINGS & TRUST COMPANY
WASHINGTON, D.C.
NS&T 9·06 12:02 2763 1408
1421914191 187500.00
– 1:0540· · ·0052·: 142'''1914191'' 01· · ·0018750000· · ·

15-52/540
14

CASH			
CHECKS	•		
	15-52	187500	00
TOTAL FROM OTHER SIDE			
TOTAL		187500	00

EXACTLY THE AMOUNT NEEDED TO CAPITALIZE THE CO-OP INTERNATIONAL BANK (ANGUILLA)

Mr. **Karol**. This time the beginning balances are only $14.07 and $100.

An identical check was immediately returned to the Co-op/St. Vincent's account.

The only result of this transaction was a generation of a deposit ticket in the exact amount needed for capital by the nation of Anguilla. Serious questions are raised by these transactions, Mr. Chairman.

The subcommittee has found that legitimate offshore bank use requires substantial capitalization. Yet the evidence we obtained indicates that the co-op banks may not have been capitalized at all, and may have used suspect, if not fraudulent, methods to appear to be capitalized.

A second question presented, Mr. Chairman, addresses safeguards offered by nations granting these banking licenses. It appears to us that in these instances, the governments of St. Vincent and Anguilla may have been deceived by these phantom capitalizations.

The fact that a mere deposit ticket may have been accepted by these governments as evidence of capitalization is a severe laxity in regulatory efforts.

Chairman **Roth**. Do we have any evidence the governments checked into it, made any investigation?

Mr. **Karol**. There is no evidence of that, Mr. Chairman.

I would like to provide for the record, signature cards, copies of monthly balances, checks, and correspondence we received from the NS&T bank.

Chairman **Roth**. That will be made part of the record.

[The material referred to was marked "Exhibit No. 18," for reference, and is retained in the files of the subcommittee.]

Chairman **Roth**. I want to thank both you gentlemen for your hard work in this area.

At this time, we call forward Mr. Jerome Schneider, president of the WFI Corp.

Under the rules of the subcommittee, all witnesses are required to be sworn.

Raise your right hand.

Do you swear the testimony you will give before the subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. **Schneider**. Yes, I do.

Chairman **Roth**. Please introduce the gentlemen who accompany you and tell us in what capacity they are here.

STATEMENT OF JEROME SCHNEIDER, PRESIDENT OF WFI CORP., LOS ANGELES, CALIF., ACCOMPANIED BY JONATHAN SCHWARTZ, ATTORNEY AND ROBERT BUCHSBAUM, EXECUTIVE DIRECTOR, WFI CORP.

Mr. **Schneider**. Thank you, Senator.

This is John Schwartz, counsel to WFI Corp., in Los Angeles and at the far left of the table, your right is Robert Buchsbaum, executive director of WFI Corp.

Chairman **Roth**. If they are going to testify, they have to be sworn in, too.

Mr. SCHWARTZ. I am purely here in my capacity as attorney or Mr. Schneider at this time.

Chairman ROTH. You are here as legal advisor?

Mr. SCHWARTZ. Counselor.

Chairman ROTH. How about the other gentleman?

Mr. BUCHSBAUM. I am here in capacity to advise Mr. Schwartz.

Chairman ROTH. Please proceed.

Mr. SCHNEIDER. Thank you, Senator.

How do I address you? Do I address you, Mr. Roth or Senator Roth?

Chairman ROTH. Either one is fine.

Mr. SCHNEIDER. Thank you.

I would like to take this opportunity to thank you for the opportunity to appear before you today to discuss the problems regarding the ownership and use of offshore banks.

I welcome these hearings graciously considering this might be the very type of forum that might clear up some of the misconceptions associated with legitimacy of offshore banking.

Before I begin, I would like to define my subject. I would like to say that offshore banking is widespread and some people really don't understand what offshore banks are.

The information I am going to provide to you today in testimony will relate solely to the use of offshore banks by offshore bank owners as distinguished from offshore bank customers, a person coming to a bank and opening up a bank account, like a Swiss bank.

Placed in this context, an offshore bank is a corporation organized and licensed under the banking laws of a foreign jurisdiction which is conducive to conducting international financial transactions with minimal tax, banking, and security regulations.

These types of banks are often called class B, because they are only permitted to deal with nonresidents of the host country.

My firm, WFI Corp., is a consulting firm which specializes in establishing offshore banks. There are approximately 100 people around the world today that can establish an offshore bank for you and I am one of them. Of the persons who you can go to establish an offshore bank or the term was used broker, and I will explain how the brokers of banks came about a little later. We are the only firm that openly maintains a policy of wishing to cooperate with the Government in terms of providing you with whatever information you need in order to conduct an investigation.

When the FBI has asked us questions on the use of offshore bank criminality, when the IRS has come to us, when the SEC has come to us, our files have been opened to them and they have been able to make cases and get information from us, and we have not resisted them in any capacity.

I am an American citizen and proud to be an American citizen and I am not a tax protestor. I want to set that straight. I am going to point out some of the things we do in our firm to make it clear to you that we are not criminals, we are not pirates, we are doing something that happens to be an unregulated activity within the United States.

I agree with you about your ideas of making it regulated. We feel that what we are doing is very, very legitimate. We are making certain that we keep it legitimate.

I would like to explain the process that is involved with selling an offshore bank. The price that we charge for an offshore bank is $35,000. The reason we keep it high is to thwart the idea that it can be acquired cheaply by someone because the fact is if it can be acquired cheaply it might be misused.

When we have a sales meeting with a particular offshore bank prospective owner, we advise them of certain important things. Our relationship stops with an offshore bank owner the minute the acquisition process is completed. We are not lawyers, we are not accountants, we are strictly merchants of convenience.

Our activities are completely legal and above board. We are not tax protestors or tax advisers. The applicant screening process that we use is much like the type of procedure that is used by the FDIC.

When we meet with a client we ask, what do you intend to do with an offshore bank? We ask them, do you have any lawyers that can advise you of the legality of how to use the bank in conjunction with your application, and have you ever been convicted of a past criminal offense?

These questions and other questions are routinely asked during the sales meeting. We advise the owners that the bank cannot be used as an instrumentality of tax fraud and we require that each person sign a paper indicating that he understands what his tax reporting obligations are to the Internal Revenue Service.

When a purchase is consumated both orally and in writing, the purchaser acknowledges he understands the banking, tax, and securities laws of the United States and of each individual State since they are complex in their applications, and that any activity conducted within the United States must be done with the guidance and advice of a competent attorney.

The purchaser further acknowledges that he must file with the Internal Revenue Service within 90 days after he acquires a bank from us.

In addition to the representations made, we commission an independent background check done by a firm, formerly Equifax Inc.

Now we use Burns Security Services. These background checks cost us anywhere from $500 to $1,000 per report. They are highly useful in determining the motives and bona fides of a prospective bank owner.

The report includes a check of civil and criminal records dating back 7 years in the city where the applicant has lived the longest.

In addition, the firm conducts interviews with the applicant's banker and business associates to ascertain the character and reputation of the applicant.

The entire process is known as vetting and I note that we are the only firm in America supplying offshore banks that performs such checks.

In perspective, you might ask, have we ever turned anybody down? I would like to say that on September 15, 1980, we were asked by an individual named William Posnet Lynas III to sell him an offshore bank. We advised him of our background checking procedure and he recommended to us that in the event he did not check out, he would like his secretary, Mrs. Traylor, to be the beneficial owner of the bank.

The next day we commissioned a background report on both himself and Mrs. Traylor and found Mr. Lynas was convicted of smuggling 55 pounds of cocaine into the United States and was sentenced to 9 years in prison—excuse me, he was sentenced to 9 years in prison and 20 months probation on March 29, 1976.

A copy of the background investigation report produced by Equifax is attached to my statement at the end. It somehow got placed as exhibit B before exhibit A, but it is at the end.

Immediately after receiving the knowledge that Mr. Lynas was convicted of a crime, we refunded his money and sent him a letter explaining the situation.

I have an observation to make taking into account the study of offshore bank criminality and the question, do offshore bank criminals really need to buy or charter a license from WFI Corp. or anybody else in order to commit a crime and the answer is clearly no. In one case in particular, which for some reason your staff study did not include in its report, was the $40 million Bank of Sark fraud.

It is considered to be by many the granddaddy of all offshore bank crimes. The criminals in this particular case did not have an offshore bank charter, they didn't have a license, or any official documentation from the Government of Sark.

In other cases such as *U.S.* versus *Crosby*, *U.S.* versus *Fedderbush*, *U.S.* versus *McDivitt* and *U.S.* versus *Parker*, those persons had expired or disenfranchsized bank charters at the time they committed their frauds. To a great extent, frauds can be committed by printing phony financial instruments in the name of banks and obtaining a third party to sign such instruments. It would clearly be illogical for an offshore criminal, if his intent is to commit a fraud, to pay $35,000 to WFI Corp. for an offshore bank charter and license if he can commit the fraud by finding the name of a bank that wasn't registered or licensed anywhere and printing phony financial documents in the name of the bank.

If new controls and legislation are contemplated to curb this type of activity, I recommend they include printers to compel them to check the legitimacy of the institutions prior to printing them. In addition, commercial banks, as was suggested here today, should check out the institutions to make certain they are existent.

I would also like to mention one country's practices for the record. The country is Anguilla. I have attached as exhibit C a list of offshore banks licensed and legally able to operate in the British Colony of Anguilla. This list was published in the Official Gazette January 28, 1983. Anguilla is probably the best example in the world of a country which, in my opinion, does not yet license applications. My two competitors, Charles Cranford of Amarillo, Tex., and Gordon Novell of Metairie, La., will sell you an offshore bank for cash with no questions asked.

The reason these gentlemen are able to provide such an incredible service is that the Government of Anguilla does not scrutinize or approve the subsequent transfer of ownership of such banks once they are licensed. This affords the criminal the opportunity to acquire a bank charter without any background checks, or any intelligence data that might state in a file accessible by U.S. law enforcement agencies who can determine who the operators of the bank are. In many cases, one can simply fly down to Anguilla and acquire a bank charter simply by providing two bank references, which I understand are not even checked.

I believe Anguilla is a time bomb waiting to blow up, and I urge the subcommittee to dedicate some of its investigative resources and legislative efforts to curb practices by the Government of Anguilla.

WFI in no way places any of its clients there any longer because of these practices.

In the interest of time, I would like to forgo reading and summarizing the rest of my statement and would like to take any questions you might have.

Chairman ROTH. We will include it as if read.*

Can you tell us how WFI runs background checks on its prospective clients?

Mr. SCHNEIDER. In terms of the reporting procedure?

Chairman ROTH. Not only the reporting but indeed determining whether or not they are qualified to buy a bank.

Mr. SCHNEIDER. The first thing we do as I mentioned in my report, we have a meeting. In the meeting we discuss the risks and benefits of owning a bank. We size the person up as to whether or not they are legitimate, what their intentions are—whether they are interested in committing a bank fraud or operating the bank legitimately. Obviously we are not going to sell a bank to someone who states to us he is going to commit a bank fraud.

Once it is agreed the person wants the bank, we will go out and order a background check. We used to use Equifax, Inc., and now use Burns International Security Services who, for about $500, will provide us with a pretty good indication of who the person is, what he has been doing in the last, let's say, 7 to 10 years. They go to the office in the State or city in which the applicant has lived the longest. They interview the banker, they interview his business associates, they will go to the person's house many times and learn as much about the prospective applicant as possible in terms of what his business dealing is, et cetera.

We will go to the courthouse in the city where he has lived the longest and check both civil and criminal records to determine whether or not the person has been in trouble with any law enforcement agencies or whatever. We will check with the Securities and Exchange Commission; we will check with the department of corporations in any State. All of this will be put together in a background check which is provided to the government of the host country that issues the licenses.

They make a determination, it is not us, as to whether this person in acceptable or not.

Chairman ROTH. Let me ask you, how many banks have you sold and how many are effectively operated today?

Mr. SCHNEIDER. If I can just get my notes, I have the statistics in my case.

[Pause.]

Mr. SCHNEIDER. The amount of banks we have sold since January 1, 1975, has been 120. Your question was, how many of these banks are operating legitimately or how many are operating at all?

Chairman ROTH. How many are operating at all at the present time?

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*See p. 401 for the prepared statement of Jerome Schneider.

Mr. SCHNEIDER. It would be difficult for me to tell because we don't keep in touch with each of the bank owners after we sell them the bank.

Chairman ROTH. Do you provide any services thereafter?

Mr. SCHNEIDER. No.

Chairman ROTH. Do you have any information as to how many of these are functioning?

Mr. SCHNEIDER. We were curious ourselves as to what people do with these banks and we did a study about a year ago and found that more than half of them don't even use the bank. They just keep them as a status symbol. It is like having an extra Rolls Royce in the garage where they like to have their own bank. I don't think I have any factual or clinical evidence to present to you today that can constructively say how many of those 120 are being used. I think the staff of the subcommittee has done more research in that area that I have.

Chairman ROTH. In other words, do you provide any services or followup after the bank is sold?

Mr. SCHNEIDER. The only types of services that we provide is the offering of a seminar or a workshop to prospective bank owners.

Chairman ROTH. That is prior to purchase?

Mr. SCHNEIDER. No, sometimes after, too. We have many of our people coming back——

Chairman ROTH. But it is the same seminar?

Mr. SCHNEIDER. Same seminar.

Chairman ROTH. In other words, once you sell it as far as you are concerned that completes your responsibility?

Mr. SCHNEIDER. That's right.

Chairman ROTH. Do you believe that such screening is 100 percent effective in keeping out criminals and assuring that only persons of good character obtain WFI banks?

Mr. SCHNEIDER. I think it is as good as we can get. I don't think it is 100 percent foolproof. I don't think the procedure for screening bank licenses in any country is 100 percent foolproof because of the fact there is always the first time offender. There is always the person that can subvert the system and commit a criminal offense for the first time. I think it is better than nothing. I think it is better than some of the practices that are being conducted in a country like Anguilla where you can go down there, pay a fee and get a license perhaps in the same day.

Chairman ROTH. I am going to turn it over to Senator Rudman to ask some questions and then we will recess until subject to the call of the Chair which hopefully will be around 12:15. I have to unfortunately go to the Finance Committee for a few minutes.

Please proceed.

Mr. SCHNEIDER. I was through answering the Senator's question.

[At this point, Chairman Roth withdrew from the hearing room.]

Senator RUDMAN [presiding]. Have you had problems with law enforcement authorities regarding this operation?

Mr. SCHNEIDER. In the sense—in what context? In terms of law enforcement agents coming to us and asking us questions about what we are doing, things of that nature?

Senator RUDMAN. I think it is a pretty plain question. I will repeat it. Have you had trouble with law enforcement authorities regarding your operation?

Mr. SCHNEIDER. No.

Senator RUDMAN. You have not?

Mr. SCHNEIDER. I don't think so.

Senator RUDMAN. I would like to remind you you took an oath here. I will ask it once more, have you had any problem with any Los Angeles law enforcement authority regarding WFI?

Mr. SCHNEIDER. To the best of my knowledge, we have been very cooperative with all the law enforcement agencies.

Senator RUDMAN. Were you sued by the Los Angeles district attorney in 1980 for making false claims?

Mr. SCHNEIDER. That was an advertising dispute.

Senator RUDMAN. Look, Mr. Schneider, this is a Senate committee. You took an oath. I am asking you some questions, I want direct answers.

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. I don't think your second answer was consistent with your first answer. The answer to my question is that in fact you have had problems with law enforcement authorities regarding your operation. I didn't characterize what kind of problems. I said problems, is that correct?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. Tell us about the problem?

Mr. SCHNEIDER. In 1980, we had run an ad in the Wall Street Journal regarding a book I had published. There were statements contained in the ad which described the 50 files that are kept on every American and some other statements related to explaining the reasons for wanting to purchase the book. The consumer protection unit of the district attorney's office challenged the statements and asked us to prove them within a period of time. We couldn't come up with clinical factual evidence so, without admitting guilt, we settled it by paying a $2,500 fine.

Senator RUDMAN. And agreeing to a restraining order on those claims?

Mr. SCHNEIDER. Yes, sir.

[The document referred to was marked "Exhibit No. 19," for reference, and is retained in the files of the subcommittee.]

Senator RUDMAN. Have you had any other trouble with law enforcement authorities?

Mr. SCHWARTZ. If I might interject, does the Senator mean in connection with the activities of WFI?

Senator RUDMAN. No, it was a general question. I asked him if he had any other problems with law enforcement authorities?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. Can you tell us about those?

Mr. SCHNEIDER. When I was very young, when I was 19 years old, I was charged with subverting the Pacific Telephone Co.'s computer and was brought to prosecution. I was convicted of theft and subsequently the judge felt—because I was very young and naive at the time—that the record should be dismissed, and expunged the record. That was in part my being 21.

Senator **Rudman**. That was actually a charge that you pled guilty to, am I correct?

Mr. **Schneider**. Yes.

Senator **Rudman**. The charge was actually the larceny of $214,000 worth of equipment from Pacific Telephone?

Mr. **Schneider**. That is correct.

Senator **Rudman**. Tell us about your background. I am curious about your education and financial background for the business that you are in.

Mr. **Schneider**. I am 32 years old today. I started approximately, in terms of financial background, when I was 23, by accepting a job from a private investor to assist in managing his investment portfolio.

I would watch stocks for him and report the price—I would read the newspaper every day and report the price of stocks for him. I would seek out company reports for him and provide him with information that would assist him in making investment decisions. It is kind of like a private investment counselor. It worked out very well for him, and through the information decisions he was able to make from my efforts, he was able to make quite a bit of money in the stock market. It led to finding a couple of other people he knew that I provided the same sort of service to.

I was living in New York at this time and I wanted to move back to California since I was a native Californian. I thought the idea of getting into the tax-haven business or consulting business to assist people in setting up tax-haven corporations or tax-haven banks was an enticing one.

I made a considerable effort to learn about it. I attended seminars, read a number of books on the subject, I consulted with lawyers to learn what the legitimacy of tax havens were, I became knowledgeable of Internal Revenue codes and some of its restrictive covenants and sections.

I felt that I developed enough rounded information in the tax-haven area to at least specialize in an area that I felt was at least very safe. I know it was the intent of Congress in the past 1970's to close down tax havens as much as possible. I didn't want to do anything that would appear to be controversial. So I felt that if I offered a business opportunity to somebody where they can go into the banking business, legitimately go into the banking business on a small scale, I was providing a useful service that might be, and which in fact turned out to be, helpful to the U.S. economy itself.

Does that answer your question, Senator?

Senator **Rudman**. I think so. You say you have sold 120 banks?

Mr. **Schneider**. Yes, sir.

Senator **Rudman**. How many of those have you actually licensed yourself; received the licenses yourself?

Mr. **Schneider**. Of the 120, 120.

Senator **Rudman**. So what you do is you acquire the licenses and then you transfer them and make a profit for your expertise in finding out how to get that bank licensed?

Mr. **Schneider**. Yes, sir.

Senator **Rudman**. Mr. Schneider, you have gone to great trouble to tell us about the screening process you go through.

Do you want this subcommittee to get the impression that it is your view, as a sophisticated person with a sophisticated investment background, that a $500 or $1,000 investigation is going to in any way insure absolutely that the wrong people won't get their hands on this license?

Mr. **SCHNEIDER**. I don't think that I could convince you or anybody of that.

Senator **RUDMAN**. Can you convince yourself of that?

Mr. **SCHNEIDER**. Yes; I can convince myself that it is helpful and I think I can convince you that it is better than nothing.

Senator **RUDMAN**. I am not sure it is better than nothing.

Let's go into the record of the people that you have licensed.

Are you aware of the fact that the principals you deal with in some cases or all cases could simply be agents for someone else, are you aware of that?

Mr. **SCHNEIDER**. Yes, sir.

Senator **RUDMAN**. In that case, what good does the investigation do when you are investigating the agents, not the principal?

Mr. **SCHNEIDER**. In those cases we undertake to do an investigation of the principal and we ask them point blank, are you representing anybody else?

Senator **RUDMAN**. What if they say no?

Mr. **SCHNEIDER**. Well, we do our best to size up the situation and determine if the person is lying. We will go out and initiate——

Senator **RUDMAN**. How do you do that, Mr. Schneider?

If I am sitting in your office and you say, are you an agent for an undisclosed principal, and I say, no, Mr. Schneider, I want this bank for myself.

How do you at that point decide I am lying?

Mr. **SCHNEIDER**. If the person is consultant with somebody else, if it appears he is just a conduit or shadow of someone else, we will obviously ask those types of questions which will at least give us more of an affirmative answer.

We absolutely ask them many times, is there anybody else involved with this bank?

Senator **RUDMAN**. Did you get the license for American Atlantic Investment Co.?

Mr. **SCHNEIDER**. Can I check my records, sir?

Senator **RUDMAN**. You certainly may. I will give them to you one by one. Let's take American Atlantic Investment Co.

[Pause.]

Senator **RUDMAN**. How about the name, Alan Hasso?

Mr. **SCHNEIDER**. Yes, sir, I have that information.

Senator **RUDMAN**. Alan Hasso was the man you dealt with?

Mr. **SCHNEIDER**. Yes.

Senator **RUDMAN**. Did you know he was an agent?

Mr. **SCHNEIDER**. I have it on my records here that indicates Mr. Hasso was the beneficial owner of said corporation.

Senator **RUDMAN**. That is what he told you?

Mr. **SCHNEIDER**. Yes.

Senator **RUDMAN**. You have no reason to disbelieve him?

Mr. **SCHNEIDER**. I had no reason to disbelieve him.

Senator RUDMAN. I am not criticizing. I am trying to prove a point. How about the World Chinese Trust Bank, Charles Hung?

[Pause.]

Mr. SCHNEIDER. Yes, sir, I have the record here.

Senator RUDMAN. Does he represent himself to be the beneficial owner?

Mr. SCHNEIDER. Yes.

Senator RUDMAN. Do you have any reason to disbelieve that?

Mr. SCHNEIDER. To the best of my knowledge; no.

Senator RUDMAN. Fine.

How about Fazle Quadri and J. Ripley, Pacific International Bank?

Mr. SCHNEIDER. No; I list the beneficial owner of that bank as Chester Chen, who is the beneficial owner.

Senator RUDMAN. He is the the beneficial owner?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. How about Beck Smith, North American Overseas Bank, Ltd.?

Mr. SCHNEIDER. Yes, sir, I have Beck Smith listed as the beneficial owner of that bank.

Senator RUDMAN. That is what Beck Smith told you?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. Vito Tanzi, Manufacturers Overseas Bank.

That is a nice sounding name. Who thinks up these names, Mr. Schneider, do you?

Mr. SCHNEIDER. We look in the banking directory and we find banks that are not anywhere else and we name them.

Senator RUDMAN. Like the Chase Overseas Bank, the one you turned down for the drug peddler?

Mr. SCHNEIDER. I agree——

Senator RUDMAN. Couldn't find that name anywhere else?

Mr. SCHNEIDER. No; not the name Chase Overseas Bank.

May I make a comment, sir?

Senator RUDMAN. After you answer my question, Vito Tanzi?

Mr. SCHNEIDER. He is listed as the beneficial owner.

Senator RUDMAN. Are you aware of the fact, with the exception of Pacific International, each of these people was interviewed, they were all agents, they may have no knowledge of how the banks are used by the principals, they went to you as an agent and immediately thereupon transferred ownership after you gave them the license which you owned, are you aware of that?

Mr. SCHNEIDER. No; I am not aware of that.

Senator RUDMAN. Can we agree for the purposes of the record, because we are building a record here, your process really doesn't work all that well, I can go through a lot more with you if you like and I am not criticizing you, I simply say if people lie to your face unless you have some powers the rest of us don't possess, you probably take them at their word absent some suspicious conduct, is that true?

Mr. SCHNEIDER. Yes, sir. I would like to make a comment.

Senator RUDMAN. Go right ahead.

Mr. SCHNEIDER. You mentioned or I think Senator Roth mentioned the idea of regulating us, the persons who provide offshore banks to people.

I think that might be a good idea. At least there might be some sort of a standard we can look to. We are unregulated now and we don't know—we are trying to operate a legitimate business in an environment of complex laws.

I would be more than happy to file with the SEC or whomever to make certain our activities are in fact proper and above board. In fact, I am open to suggestion.

If a staff of this subcommittee has any ideas how I can improve the background checking procedure of our business, I would be more than happy to initiate such recommendations.

Senator RUDMAN. Mr. Schneider, are you a lawyer?

Mr. SCHNEIDER. No; I am not.

Senator RUDMAN. Your lawyer sitting to your left, is your lawyer a corporate lawyer or security lawyer?

Mr. SCHNEIDER. Both.

Senator RUDMAN. Have you ever considered the fact that you might, in fact, be selling securities which may be subject to regulation? Have you ever discussed that with anyone?

Mr. SCHNEIDER. Yes; we have. We have looked at the issue quite extensively at the time I started business. Mr. Schwartz furnished me with an opinion that found we are performing no more of a service than CT Corporation.

[Witness conferring with counsel.]

Mr. SCHNEIDER. And the Securities and Exchange Commission conducted an extensive interview of myself at their office in Los Angeles, conducted by a staff attorney, and it was found that we did nothing wrong and we were not violating the securities laws.

Senator RUDMAN. However, you said in your brief comment that you think it might be a good idea to have some sort of standards and guidelines and some sort of regulation?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. So if some changes in the law were made and you would be required to register with the SEC, you would not have any problem with that?

Mr. SCHNEIDER. I would not have any problem, sir.

Senator RUDMAN. Talking about cooperating with the subcommittee do you recall when the subpena was received by your company?

Mr. SCHNEIDER. This subpena?

Senator RUDMAN. The first subpena for a number of records?

Mr. SCHNEIDER. August 9, 1982.

Senator RUDMAN. Am I correct that some of those records were just produced today?

Mr. SCHNEIDER. The balance of the ones due were produced today, yes, sir.

Senator RUDMAN. Mr. Schneider, you have sold 120 banks and you licensed all of those 120 banks?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. What is your inventory right now of unsold licenses that you hold on your shelf?

Mr. SCHNEIDER. Nineteen.

Senator RUDMAN. So you have 19 banks, in your portfolio available for sale at this time?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. Could you tell us which countries they are in?

Mr. SCHNEIDER. They are in the Marshall Islands.

Senator RUDMAN. Are these the first banks you have licensed in the Marshall Islands?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. Did you get the charters for all 19 at once?

Mr. SCHNEIDER. Yes, sir.

Senator RUDMAN. Tell us approximately what the filing fee is for a bank in the Marshall Islands?

Mr. SCHNEIDER. The licensing fee or both? The registration fee?

Senator RUDMAN. What is their fee that is paid to the Government?

Mr. SCHNEIDER. $350.

Senator RUDMAN. Per bank charter?

Mr. SCHNEIDER. Per bank charter. In addition the bank must maintain a $10,000 deposit on the island in order to operate.

Senator RUDMAN. So for $119,000 plus $350 times 19, whatever that comes to, that is your investment in those 19 banks?

Mr. SCHNEIDER. We didn't pay in the capital. Our investment is the $350.

Senator RUDMAN. I see, for about $7,000 you have these sitting on your shelf and if somebody wants to activate them, they will give you a check for $10,000 or simply take the license and they will go there with $10,000?

Mr. SCHNEIDER. It is not that easy. The Government has to approve the bank owner prior to us being able to release the documents.

Senator RUDMAN. You are the bank owner now, aren't you?

Mr. SCHNEIDER. The Government scrutinizes any subsequent transfer of ownership.

Senator RUDMAN. Do they scrutinize it very closely?

Mr. SCHNEIDER. Given the procedures we have discussed today, we feel they are better than nothing.

Senator RUDMAN. Why did you choose the Marshall Islands all of a sudden?

Mr. SCHNEIDER. Mainly we shifted out of the Marianas because of the fact Mr. Shockey of the Enforcement and Compliance Division of the Comptroller's Office rattled them over there and got them very upset.

Senator RUDMAN. The Marshall Islands are under our jurisdiction also, are they not?

[Witness conferring with counsel.]

Mr. SCHNEIDER. It is in a transition stage now, sir. It is presently considered to be part of a trust territory of the United States which I understand is being phased out and phased down. There is an agreement being negotiated right now between the executive branch of this Government and the Marshall Island government relating to the independence of the Marshall Islands. They are not going to be—they are not going to be like the Marianas, they are going to be independent completely. They are working toward that end objective.

So to answer your question—what is their status with the United States—I can't really answer specifically because I don't think anybody knows specifically right now.

Senator RUDMAN. You said in your statement that these banks as you define them in your statement are conducive to conducting international transactions with minimal tax, banking and securities regulations?

Mr. **Schneider.** Yes.

Senator **Rudman.** Which, of course, is true. We are all aware of that. Tell us about some of the international financial transactions some of your customers have entered into after you sold them the banks?

Mr. **Schneider.** One bank in particular, I understand the investigators of the subcommittee have been out to visit, J. David Banking Co., is a bank that was sold to J. David Co. in La Jolla, Calif., which is a brokerage concern, I had an interview—or my associate had an interview—with the managing director of that bank and it was found that they used the bank as a way of doing financial intermediation between France and the United States, essentially to bring money out of France, which is a block currency country, into the United States for investment purposes.

Senator **Rudman.** Can you tell us about any other international transactions?

Mr. **Schneider.** Yes; LaSalle Overseas Bank owned by Cliff Johnston, I understand he uses it—excuse me a second——

[Witness conferring with counsel.]

Mr. **Schneider** [continuing]. He uses the bank to raise capital from the Euro-dollar market in terms of having a vehicle that can be used to bring capital in from Europe.

Senator **Rudman.** Are you familiar with what the Wellington International Bank & Trust of St. Vincent has been doing?

Mr. **Schneider.** I understand that bank was involved as a part of a bank fraud, complete fraud.

Senator **Rudman.** Did you license that originally?

Mr. **Schneider.** Yes; and I sold it to Harley Peters.

Senator **Rudman.** How about Deana Williams, and International City Bank, Ltd., are you aware of what they did?

Mr. **Schneider.** Yes, sir.

Senator **Rudman.** What did they do?

Mr. **Schneider.** I am familiar with what the characteristics of the fraud were. I understand the Williams' were charged with a crime and they fled to avoid prosecution. I understand the bank was somehow used but it wasn't specifically related to me how it was used. I understood it was part of a whole scheme.

Senator **Rudman.** They have been charged by the State of Arizona with about a half million dollars fraud, tax-shelter fraud and a few other things.

The chairman will be back in a few moments. I am going to have to leave for another hearing. I will simply say to you, Mr. Schneider, I think the weight of your testimony probably indicates that what you are doing may well be allowed by State and Federal law and no one has accused you of breaking any law that we are aware of but it certainly seems to me at least that you furnish a service which makes it rather easy for people to get hold of an instrumentality which in many ways can work to the detriment of legitimate interests. So, I suspect your recommendation on regulations will be looked at by the subcommittee.

The subcommittee will stand in recess until the chairman returns.

[A brief recess was taken at 12:13.]

[Member of the subcommittee present at the time of recess: Senator Rudman.]

[Member of the subcommittee present at resumption of the hearing: Senator Roth.]

Chairman ROTH [presiding]. The subcommittee will please be in order.

I apologize to everyone here for having to recess the subcommittee, but it was beyond my control.

Mr. Schneider, I have a number of additional questions I would like to ask you. You have informed the subcommittee that you formed and sold banks and companies in such places as Anguilla, Montserrat, the Cayman Islands, Panama, St. Vincent, Northern Marianas Islands. Why did you choose those particular jurisdictions to form your banks? Was it because of their strict secrecy laws?

Mr. SCHNEIDER. No; quite the contrary, sir. The laws of each of the countries have characteristics in their laws which provide an incentive for an investor to establish a corporation or bank in those jurisdictions.

Chairman ROTH. What are those incentives?

Mr. SCHNEIDER. In the case of the Cayman Islands, they do have secrecy, that is the point. They have no taxes there on the profits, income or capital gains of a corporation set up there. Generally speaking, it is an environment where there is a minimal amount of tax, banking on its security regulations. In the Marianas in particular there is no secrecy laws as part of the ninth circuit.

Chairman ROTH. In other words, you are saying the principal purpose of going to these countries—despite your earlier statement about denying secrecy—it is a factor, if I understood your later testimony.

Mr. SCHNEIDER. It is a component.

Chairman ROTH. It is a factor?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. It is also in fact a tax haven and to avoid U.S. regulations?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. Does it bother you in the ethical sense that you are promoting the sale of institutions that help enable Americans to avoid local law?

Mr. SCHNEIDER. Well, it doesn't bother me any more than it might bother Merrill Lynch & Co. who has a bank in Panama, brass plate type bank; or whether it bothers the Dow Chemical Corp. which has a bank in Switzerland.

Chairman ROTH. Are you saying Merrill Lynch is not for a legitimate purpose?

Mr. SCHNEIDER. No; I am saying I only advocate the legitimate use of offshore banks, I am not advocating illegitimate use.

Chairman ROTH. You just said the reason was secrecy, less regulation and a tax haven.

Mr. SCHNEIDER. Sir, I think that is the reason Merrill Lynch has gone to Panama.

Chairman ROTH. You are saying then that, in your judgment, it is not a legitimate purpose for their institution there, is that correct?

Mr. SCHNEIDER. Well, in what context do you define legitimate?

Merrill Lynch obviously is this country's largest brokerage concern and they go to Panama to operate an offshore bank there, to operate I assume in a wholly legitimate matter and there is no law that says Merrill Lynch can't set up a bank in Panama.

Chairman ROTH. You are going around selling banks, you are having seminars where you pay a great deal of attention to the fact there are low taxes?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. You also say that you don't followup what these banks do. I am not asking you the question of whether it is legal or illegal, I am just wondering whether it bothers you that you are helping promote institutions that at least make it possible for the unscrupulous to avoid taxes, to avoid regulations?

Mr. SCHNEIDER. Sir, I think it bothers me greatly when someone uses a bank for wholly illegitimate purposes. It is beneficial to the U.S. economy to bring foreign investment dollars into the United States. And if offshore banks are a vehicle through which foreign investment money can come into the United States, I think it is positive for the U.S. economy in itself.

Chairman ROTH. But you agree that it would be highly desirable for the Federal Government to begin regulating this kind of activity?

Mr. SCHNEIDER. I didn't say that, I think there are a lot of problems here. I think these hearings are good and I think some legislation should come out of them to prevent the abuses, but at the same time I think there should be a preservation of the rights of Americans to compete in legitimate international banking business.

Chairman ROTH. Have you played any kind of a role in any of the several jurisdictions where WFI has licensed banks in writing laws or regulations that help provide secrecy?

Mr. SCHNEIDER. Not on the subject of secrecy.

Chairman ROTH. In what areas have you dealt with foreign authorities?

Mr. SCHNEIDER. In the area of getting license applications, we recommended procedures to the government of Montserrat that they use a background check when screening applicants. Right now they don't use a service like Equifax or Burns Security to check out a license applicant. If you were to get on a plane and go to Montserrat and set up a bank, you provide two banking references to them, they would do their own check through their own people and that would be satisfactory. We recommended they use services of private investigation firms to conduct such checks. We have promoted that.

Chairman ROTH. Let me ask you again, have you played any kind of a role in writing laws or regulations permitting offshore banks in any jurisdiction outside the United States?

Mr. SCHNEIDER. Yes, sir; we played a role in the Northern Marianas Islands through our attorneys and we played a role in Montserrat by helping to improve the legislation there and we played a role in the Marshall Islands to the extent we recommended to the government what they should do to check out applicants and how they should conduct themselves as a respectable international financial center.

Chairman ROTH. Did you, in any instance, have anything to do with secrecy?

Did your lawyers or you in any way discuss the matter of secrecy?

Mr. SCHNEIDER. On the subject of secrecy, that whole issue was dealt with my lawyers and I assume you are referring to the Mariana Islands?

Chairman ROTH. I am asking any jurisdiction?

Mr. SCHNEIDER. In Montserrat, there was a secrecy law in place. We asked——

Chairman ROTH. Did you or your lawyers have any discussions about secrecy, secrecy laws with officials there?

Mr. SCHNEIDER. Yes; to make it an international finance center, we asked the Government to preserve the integrity of its bank secrecy laws by——

Chairman ROTH. What do you mean by "integrity of secrecy laws"?

Mr. SCHNEIDER. In other words, in the same context we are merchants of convenience by providing bank charters to responsible persons. At the same time, a component which helps sell the bank——

Chairman ROTH. In other words, you were urging upon them either directly or through your lawyers bank secrecy laws; is that correct?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. So you are not just an innocent bystander, you are actually promoting through your enterprise this kind of operation?

Mr. SCHNEIDER. Yes, sir, however, may I make a comment?

Chairman ROTH. Yes.

Mr. SCHNEIDER. The idea of bank secrecy being used for illegitimate purposes is well noted. But I think there is some legitimate reason for bank secrecy, too.

Chairman ROTH. You are well aware of the fact that bank secrecy has been used as a means of tax avoidance and——

Mr. SCHNEIDER. It is a problem, yes, sir.

Chairman ROTH. The reason you wanted it is it enabled you to help sell banks in this country which you took no responsibility for thereafter, that is correct; isn't it?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. So that part of your package, part of your program is to promote the very kind of laws that enables Americans who want to, and others, to avoid the laws on the books; isn't that correct?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. Have you had any discussions—what were your discussions at Montserrat?

Mr. SCHNEIDER. With the government officials, I assume you are referring to.

Chairman ROTH. Yes; or their representatives.

Mr. SCHNEIDER. I made several trips to Montserrat and discussed offshore banking with the Chief Minister, Mr. John Osborne with the Governor, Gov. David Dale and the Attorney General, John Wilson, and with various other persons involved in the government and explained to them what offshore banking is. They felt that offshore——

Chairman ROTH. What do you mean by explaining what offshore banking is?

Mr. SCHNEIDER. In terms of what it means to be an offshore banking center.

Chairman ROTH. Did you discuss what is necessary in order to make it attractive to potential purchasers?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. Did you talk about secrecy?

Mr. SCHNEIDER. That was a component, yes, sir.

Chairman ROTH. Did you talk about low taxes or no taxes?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. Did you talk about little regualtion?

Mr. SCHNEIDER. I don't think we discussed little regulation. I don't think it is within the character of the government there to have a lot of regulation because it is such a small government.

Chairman ROTH. Did you provide any kind of gratuity to any of the officials or representatives of officials?

Mr. SCHNEIDER. No, sir.

Chairman ROTH. No kind of——

Mr. SCHNEIDER. No, sir.

Chairman ROTH. Who did you deal with in St. Vincent?

Mr. SCHNEIDER. With Rene Baptist, who is the manager of the trust authority there.

Chairman ROTH. Did you provide him or any of the officials or representatives of St. Vincent with any gratuity or thing of value?

Mr. SCHNEIDER. No, sir.

Chairman ROTH. Who did you deal with in the Northern Marianas?

Mr. SCHNEIDER. Primarily through our lawyers. They were the people who performed all the negotiations with the Government officials and I had a meeting with the Governor, the Lieutenant Governor, the chief counsel to the Governor and the Director of Finance.

We discussed offshore banking on just one occasion and they felt very receptive toward it.

Chairman ROTH. Again, you discussed secrecy?

Mr. SCHNEIDER. Yes; we did.

Chairman ROTH. Did you discuss the problem of low or no taxation?

Mr. SCHNEIDER. Yes, sir.

Chairman ROTH. Did you talk about regulations?

Mr. SCHNEIDER. We talked about regulations, yes, sir.

Chairman ROTH. What was the nature of those discussions?

Mr. SCHNEIDER. Well, Marianas is in a strange situation because many of the laws that are applicable to the United States are applicable to the Northern Marianas Islands. The government said to me they wanted to offer bank secrecy but they couldn't because of the fact they were judicially in the ninth circuit.

We told them that bank secrecy is just a component of being an international center and we felt we could promote the country as a good banking center without secrecy. They thought that was good and wanted to do that.

We discussed the idea of licensing a number of banks, which we did, and they were amenable to that. They were real concerned about creating what we call tension with the U.S. Government in relation to conducting the——

Chairman ROTH. I am sorry, I couldn't understand it.

Mr. SCHNEIDER. They didn't want to create any tension, friction between the U.S. Government and the Northern Marianas Government. But, on the other hand, it is a poor country and they need money.

Chairman **Roth**. In the Marianas, were you given exclusive right to sell licenses?

Mr. **Schneider**. No, sir.

Chairman **Roth**. Were you in any other country?

Mr. **Schneider**. No, sir.

Chairman **Roth**. Did you ever say you had an exclusive right?

Mr. **Schneider**. No; we never made any representation to anyone that we were an exclusive agent or have exclusive rights in any country.

[Witness conferring with counsel.]

Mr. **Schneider**. I did have an agreement with our attorneys, Fennell and Phillips. They agreed that they would not compete with us because, obviously, if we set up a number of banks, somebody can go to them directly and set up banks. We found later they violated that agreement, people went to them directly to set up banks.

Chairman **Roth**. Mr. Weiland.

Mr. **Weiland**. Mr. Chairman, on this question of secrecy in the Marianas Islands, Mr. Schneider has it been your position in the past there was bank secrecy in the Marianas?

Mr. **Schneider**. There is secrecy laws as part of rules and regulations that says they permit and authorize the confidentiality of the records between the clients and bank and client and government.

There has been a liberal interpretation of that to say it can in fact be considered a secrecy law. That was told to me by our attorneys so we were advised——

Mr. **Weiland**. The staff is somewhat confused——

Mr. **Schwartz**. Excuse me, Mr. Weiland.

I think Mr. Schneider would like to ask me a question.

Would you hold on for a minute, please?

Mr. **Weiland**. Excuse me.

[Witness conferring with his counsel.]

Mr. **Schneider**. Continue, please.

Mr. **Weiland**. Mr. Schneider, there is a statement in one of your circulars dated August 1, 1982, in which you are promoting the Marianas as a jurisdiction to locate an offshore bank.

[The circular referred to was marked "Exhibit No. 20," for reference, and follows:]

Exhibit No. 20

THE MARIANAS AS AN OFFSHORE BANKING CENTER

On March 5, 1982 regulations were enacted in the Commonwealth of the Northern Mariana Islands, making it possible for WFI Corporation to offer for sale a series of special-status international banks with powers and benefits available in no other offshore banking center today.

For those interested in acquiring an offshore bank or establishing one, there are two factors most important to consider. The first, how much cash will be required as a contribution of capital to the bank in order to commence business? Second, how much prior banking experience must the owners and/or the managing persons have in order to qualify for a charter?

On this subject, the Mariana Islands provide one of the best situations. The regulations only require $10,000 in cash in order to legally commence business. In addition, the regulations eliminate in full the usual requirement for prior banking experience. The owners or managing persons need no special experience or training in order to operate a bank.

These two reasons among others are why the Mariana Islands is perhaps one of the best locations in the world to own an offshore bank.

In evaluating the value of an offshore center, there are eight questions you must have positive answers in order to be certain that the offshore bank you are contemplating using will be successful.

The questions are:

(1) Is the Government stable?

(2) Does the jurisdiction have good communication systems with the United States?

(3) Does the legislation in the jurisdiction closely accommodate the type of business activities you are contemplating?

(4) Are there reliable reputable, and efficient firms to handle your business and represent your affairs?

* * *

ongoing requirements for the continuation and operation of an offshore bank in the Mariana Islands:

"(A) It has deposited a minimum of $10,000 in a licensed retail bank within the Commonwealth of the Northern Mariana Islands, and the local agent of the licensee has filed an affidavit so stating with the Director of Commerce and Labor. At no time shall an offshore banking corporation maintain a local deposit of less than $10,000.

"(B) Its manager or agent residing in the Commonwealth of the Northern Mariana Islands has taken an oath that he will, as far as the duty devolves upon him, diligently and honestly administer the affairs of the bank and will not knowingly provide or willfully permit to be violated any of the provisions of law applicable to the bank and the oath, subscribed by the manager or agent taking it has been transmitted to the Director of Commerce and Labor.

"(C) It has provided such information regarding stockholders of the offshore banking corporation as the Director of Commerce and Labor may reasonably require. In complying with this requirement. a review of the financial and criminal background of a susbtantial stockholder by a reputable agency engaged in the business of investigation shall be sufficient. *No information provided in compliance with these regulations shall be furnished to any third party . . .*" [Emphasis added.]

Section 5 of the regulations states that the license fee shall be $1,000 per year.

Section 6 of the regulations states that each offshore bank shall submit to the Director of Commerce and Labor twice in each annual year a report of its condition on the date that the director may set.

TAXATION

Offshore banks incorporated and licensed in the Mariana Islands are provided preferential tax treatment under the Revenue and Taxation Act of 1982, which became effective June 1, 1982.

Under the act, pursuant to Chapter I, Section 104(P), offshore banks are defined as an entity incorporated in the Commonwealth of the Northern Mariana Islands whose principal purpose is (1) negotiating, making and extending loans to borrowers who are not residents or citizens to the Mariana Islands or (2) borrowing from lenders who are not residents or citizens of the Mariana Islands.

Mr. Weiland. A particular quote has struck our attention. It says, "No information provided in compliance with these regulations shall be furnished to any third party."

Do you remember inserting that statement in your circular?

Mr. Schneider. Yes.

Mr. Weiland. The actual regulation, upon our examination, goes on to say, "Except upon court order, subpena or other judicial process or the expressed consent of the parties involved."

[The document referred to was marked "Exhibit No. 21," for reference, and follows:]

Exhibit No. 21

SECTION 4—COMMENCEMENT OF BUSINESS

After issuance of an Offshore Banking Corporation license, a licensee cannot commence business in the Commonwealth of the Northern Mariana Islands until:

(a) It has deposited a minimum of $10,000.00 in a licensed retail bank within the Commonwealth of the Northern Mariana Islands, and the local agent of the licensee has filed an Affidavit so stating with the Director of Commerce and Labor. At no time may an Offshore Banking Corporation maintain a local deposit of less than $10,000.00.

(b) Its manager or agent residing in the Commonwealth of the Northern Mariana Islands has taken an oath that he will, as far as the duty devolves upon him, diligently and honestly administer the affairs of the corporation and will not knowingly violate or willfully permit to be violated any of provisions of law applicable to the corporation and the oath, subscribed by the manager or agent taking it, has been transmitted to the Director of Commerce and Labor and filed in his office.

(c) It shall have provided such information regarding stockholders of the Offshore Banking Corporation as the Director of Commerce and Labor may reasonably require. In complying with this requirement, a review of the financial and criminal background of substantial stockholders by a reputable agency engaged in the business of investigation shall be sufficient. No information provided in compliance with these regulations shall be furnished to any third party, except upon court order, subpoena, other judicial process or the express consent of the parties involved. This duty to provide information regarding stockholders shall be a continuing duty, and every change of stockholders shall be reported within thirty (30) days.

SECTION 5

The license issued pursuant to these rules shall be for a term of one year (1), renewable for terms of one (1) year. The license fee for each license period shall be Two Hundred Fifty Dollars ($250.00) payable at the time an application for licensure is filed with the Director of Commerce and Labor.

Mr. WEILAND. Why did you omit the last few phrases of that sentence?

Mr. SCHNEIDER. Just to emphasize the point. When asked about it specifically, we explained the whole thing in context. It is part of the marketing process.

Mr. WEILAND. Part of your marketing process is to attract clients by representing there is bank secrecy in these various jurisdictions; isn't that true?

Mr. SCHNEIDER. We have represented there is bank secrecy in various jurisdictions——

Mr. WEILAND. Including the Marianas?

Mr. SCHNEIDER. It all depends on what you define as bank secrecy. There is a secrecy law there.

Mr. WEILAND. Doesn't that statement I just read you, sir, suggest there is some kind of bank secrecy in the Marianas?

Isn't that what you were suggesting to your potential clients?

Mr. SCHNEIDER. Isn't that in fact the case? Isn't there a degree of bank secrecy there?

Mr. WEILAND. Whatever secrecy there might be is tempered by the remainder of the sentence that it can be pierced by court order, subpenas or other judicial process.

Mr. SCHNEIDER. I understand that.

Mr. WEILAND. That is not the case in a jurisdiction such as Montserrat?

Mr. SCHNEIDER. That is right.

Mr. WEILAND. Can any jurisdiction succeed as an offshore bank center for your type banks without a secrecy law?

Mr. SCHNEIDER. Yes, sir.

Mr. WEILAND. Which jurisdiction would that be?

Mr. SCHNEIDER. If a secrecy law isn't a prerequisite it is a component to making an offshore bank attractive to a bank owner.

Mr. Weiland. How many banks have you sold in the Marianas?

Mr. Schneider. Thirty-eight.

Mr. Weiland. How many of those banks are still operating?

Mr. Schneider. I don't have any idea.

Mr. Weiland. Our information is that virtually all of those licenses have been allowed to lapse.

Would that surprise you?

Mr. Schneider. It would surprise me. I would think at least several of them would continue. There is a story behind the Marianas and what happened there.

Mr. Weiland. Maybe we will have time for that later.

Mr. Chairman, I just have one or two other quick questions.

You mentioned Merrill Lynch's bank in Panama. Would you give us the name?

Mr. Schneider. Merrill Lynch International Bank, Ltd.

Mr. Weiland. Going back to a question of Senator Rudman, you indicated you sold 120 banks?

Mr. Schneider. Yes.

Mr. Weiland. And you have 19 on the shelf, so to speak?

Mr. Schneider. Yes, sir.

Mr. Weiland. Is that 139 banks the total number of banks that you have ever licensed at least since 1975?

Mr. Schneider. No; I furnished you a statistic sheet which identifies that we bought 157 banks and sold 120 and 18 have since lapsed and we have 19 on hand.

Mr. Weiland. You actually licensed some banks in Anguilla, did you not?

Mr. Schneider. Please repeat the question?

Mr. Weiland. You licensed some banks in Anguilla?

Mr. Schneider. We never licensed banks in Anguilla, we incorporated them.

Mr. Weiland. Also in St. Vincents?

Mr. Schneider. Yes, sir.

Mr. Weiland. And today you are very critical of the situation in those two jurisdictions; isn't that true? You have made critical remarks?

Mr. Schneider. I made critical remarks about Anguilla. I think there is a problem there.

Mr. Weiland. You were quoted in the Wall Street Journal one day saying St. Vincent has now allowed numbers of unscrupulous persons into the banking business. That is a critical type of comment?

Mr. Schneider. The reason I didn't criticize them here today is because I don't think they are licensing any new banks on a regular basis anymore. I don't think people consider St. Vincent as a viable selection for a jurisdiction now.

Mr. Weiland. What happened to Anguilla to change your mind about that jurisdiction?

Mr. Schneider. I think it is the way the local political situation warks there. The government there is influenced greatly by—it is a very small government and they are influenced greatly by the local incorporation agents who essentially are the people who bring business in for the government.

The incorporation agent I used at the time in 1979 to set up the banks, we did there was jealous of us because we had been making a profit on the banks and told the government he didn't think that WFI should be allowed to continue in Anguilla.

So they refused to give us any more charters. We found that a couple of people who we had talked to went to Anguilla and were able to get bank charters immediately without any references or anything.

It is as much a political process than it is an administrative process.

Mr. WEILAND. So you are critical of the situation in Anguilla now because your competitors are being granted the licenses there instead of you?

Mr. SCHNEIDER. That is a factor but I think there is inherently a problem there because of the fact my competitors' practices aren't like mine in the sense I don't think they do any background checks.

Mr. WEILAND. We have discussed the efficacy of your background checks.

Mr. Chairman, that is all I have.

Thank you.

Chairman ROTH. There was a relatively recent article in the Wall Street Journal about you and your operations.

One of the things "Mr. Schneider says that his own survey of a sample of 16 banks he has sold shows that 38 percent are profitable."

Is that correct?

Mr. SCHNEIDER. Yes; it is, sir.

[The Wall Street Journal article referred to follows:]

Offshore Offerings

Tax-Haven Promoter, Selling Banks in Pacific, Draws Official Interest

Jerome Schneider Says Isles Elude Regulators' Reach, But Regulators Disagree

The Pacific Telephone Caper

By JOHN J. FIALKA
Staff Reporter of THE WALL STREET JOURNAL

LOS ANGELES—Over 500 hopeful investors and businessmen paid $435 apiece to attend a seminar here last spring on how they could find "profit, privacy and tax protection" by learning the art of "offshore banking."

Among the speakers at the Century Plaza Hotel was Jerome Schneider, a baby-faced 31-year-old who bills himself as "America's foremost authority on offshore banking laws." He says he has helped establish over 150 offshore banks in various parts of the world, most of them in the Caribbean.

The word from Mr. Schneider was that the heyday of the Bahamas, the Cayman Islands and other Caribbean tax havens is over. The new investor interested in offshore-bank schemes to avoid U.S. taxes should consider such seemingly remote but allegedly soon-to-boom places as Guam and Saipan.

Mr. Schneider's remarks have helped provoke a stirring of entrepreneurial hopes on Pacific islands that operate under U.S. laws. In recent months, legislators in Palau, Guam and the Northern Mariana Islands have all passed bank-secrecy laws in hopes that some of the new riches will come their way.

There is also a stirring in the U.S. Treasury and Interior departments, where officials aren't enthusiastic about the prospect of new income-tax havens opening in U.S. Trust Territories and possessions in the Pacific.

Republican Sen. William Roth of Delaware, the chairman of the Senate's permanent subcommittee on investigations, is also interested in what Mr. Schneider has been saying. He has subpoenaed Mr. Schneider's records for coming hearings that will explore what the senator calls a "growing trend" in the sale and use of offshore banks "for tax evasion and other unlawful purposes."

Mr. Schneider's company, WFI Corp., organized the seminar here, and it later sent many of those who attended a brochure describing what Mr. Schneider regards as the ultimate deal in offshore banking: a bank located on an island where money is insured by the U.S. Federal Deposit Insurance Corp. but that is, Mr. Schneider insists, beyond the reach of U.S. tax and regulatory authorities.

Mr. Schneider's company has assembled a private stock of 50 licenses and corporate charters for banks on Saipan, the island capital of the Commonwealth of the Northern Marianas. According to his company's "offering memorandum," he can be persuaded to part with one of them for about $25,000, but first he must be sure that the buyer has a net worth of at least $150,000, "good character and reputation for honesty," and no criminal record.

Impression of Credibility

Such a bank, according to the memorandum, consists mainly of a box of legal documents and preprinted certificates of deposit, letters of credit, stationery and other materials bearing a name chosen by WFI to give the bank "an impression of distinction and credibility."

Because an offshore bank, by legal definition, isn't permitted to trade with the locals, there would be no need for tellers, a vault or even a building. In fact, WFI says, there is really no need for the bank's owner to go to Saipan, which is about 6,000 miles west of Los Angeles. Transactions can all be taken care of by an existing Saipan trust company, acting as the bank's local agent.

But, WFI suggests, there are ways to make this offshore bank look larger than it is. One way is to use it to lend money to a third party, then relend it to the bank, which then relends it back to him and so on. On the bank's books, the transaction is treated as not one but several loans, each of which, WFI says, "adds to the bank's net worth and earnings."

"Theoretically, this process may be recycled over and over again; however, its overall effect after several recyclings would appear fraudulent," the WFI offering memorandum cautions. "Therefore, this technique should be used like sugar in coffee: very sparingly!"

Laws That Don't Apply

One of Mr. Schneider's big selling points is that the offshore banker can do all this without risking his required $10,000 of capital. He can put that in one of Saipan's commercial banks, all of which are insured by the FDIC. Another selling point: "The U.S. government has no hand in lawmaking there (the Marianas). American tax and banking laws as they would ordinarily apply to banks in the U.S. states or possessions do not apply in the Marianas as a result of its agreement with the U.S."

Some people find this too good to be true. Daniel H. MacMeekin, an Interior Department lawyer, says he finds it incredible.

"That's just wrong," Mr. MacMeekin says, asserting that a covenant worked out between the U.S. and the Northern Marianas in 1975 makes most U.S. banking laws applicable there. Moreover, he notes, Congress has made the U.S. Internal Revenue Code applicable to the Northern Marianas as of Jan. 1.

Mr. MacMeekin's opinion is worth noting because he is executive director of a commission set up by the Interior Department to determine how much federal law applies to the Northern Marianas. The department administers the trusteeship set up by the United Nations in 1947 that gives the U.S. "full powers of administration, legislation and jurisdiction" over the Marianas and other former Japanese holdings in the Pacific.

Mr. Schneider's vision of the Northern Marianas as the Cayman Islands of the Pacific appears to have won the enthusiastic backing of some officials on Saipan. After lobbying by a local law firm retained by WFI, a set of "emergency rules" for the licensing of offshore banks was drawn up last year. Later, the islands' legislature exempted offshore banks from local taxes and adopted a $1,000-a-year licensing fee.

But Peter Van Name Esser, acting attorney general of the Northern Mariana Commonwealth, says the enthusiasm has begun to wane sharply, especially after recent visits from a U.S. congressional delegation and the FBI, both of which asked questions about WFI, one item on the agendas for their visits.

Because the legislature is worried about the rumblings from Washington, which supplies half of the islands' annual budget, there now is talk about eliminating the tax exemption or adopting a much higher license fee, Mr. Esser says.

"There just isn't much stability here (for offshore banks), and anyone who represents otherwise doesn't know what is going on," he concludes.

Nonetheless, Mr. Schneider insists in an interview in his well-appointed suite of offices in the Century City complex here that although there appear to be some "gray-area issues" in the law, ultimately his banks will prove to be both legal and impenetrable to federal investigators.

Freedom from snooping government investigators is a major concern of Mr. Schneider's. In a recently published book, he says that "high-school computer whiz kids have demonstrated an extraordinary ability," to break into computer systems and gain access to classified information. "If they can do it," he writes, "think of what the IRS can do when it decides to pursue a taxpayer."

Among other things, Mr. Schneider says, the IRS can use computerized bank records to piece together all the details of an individual's private economic dealings.

Penetrating privacy is another subject on which Mr. Schneider is something of an authority. According to civil-case records in the California Superior Court for Los Angeles, Mr. Schneider unlawfully obtained $214,649.63 of telephone equipment from Pacific Telephone & Telegraph Co. in the early 1970s and resold most of it through a company he set up called Creative Systems Enterprises.

Offshore Offerings: Promoter Selling Banks in Pacific Draws Official Scrutiny Despite Claims of Immunity

An exhibit on file in the final judgment in the civil case refers to Mr. Schneider's "plea of guilty on May 15, 1972, for grand theft" of Pacific Telephone property and equipment. After serving a 60-day jail term, Mr. Schneider, then 21 years old, became something of a local hero because of a Los Angeles Times story. The article portrayed Mr. Schneider as a "boy electronic wizard" and quoted him as saying he had "discovered unique methods" that allowed him to crack the company's computer code and order delivery of equipment using only a push-button telephone.

Mr. Schneider wouldn't say what his methods were, but in setting up a 1974 seminar he did parlay the publicity into a new consulting business. "From his unique vantage point as a reformed computer criminal, Jerry Schneider now presents a three-day seminar on computer security unlike any ever given in the past," says a brochure he sent to local businessmen at the time.

Pacific Telephone's Response

In the eyes of Pacific Telephone, however, Mr. Schneider remained less than heroic. For one thing, papers in the company's civil suit against Mr. Schneider assert, he burned his records to frustrate the company's efforts to recover money and equipment from him. Edwin W. Duncan, an attorney who handled the phone company's civil case, says, "What we did, in essence, was that we reconstituted his records by examining his various bank accounts."

Mr. Duncan insists that Mr. Schneider's real method of operation was "very unsophisticated." What Mr. Schneider did, he says, was to bribe a telephone-company employee into giving Mr. Schneider a passkey that gave him access to various company offices. The phony delivery orders to the computer, Mr. Duncan says, were carried out with the help of a stolen phone-company manual that contained the necessary codes.

For all his sleuthing, though, Mr. Duncan was only able to get Mr. Schneider to pay back $8,490, in payments of $100 a month. And in 1975, convinced that Mr. Schneider had reformed, a local judge invoked a California law that allowed Mr. Schneider to expunge his criminal offense from the records by changing his plea of guilty to not guilty. After that, the court records in the criminal case were sealed.

In his new role as the man who checks out and certifies the suitability of potential new offshore bankers for the Marianas, Mr. Schneider doesn't like to talk about his former life. "I sealed those records!" He exclaims at one point during an interview.

Mr. Schneider's career as the nation's "foremost authority" on offshore banks appears to have begun in 1975 on the Caribbean island of St. Vincent, which he touted for a time as the best location in the world. Sometime in the late 1970s, he switched to Montserrat, another Caribbean island.

Now, after selling, he says, over a hundred banks in the Caribbean, Mr. Schneider has abandoned the area. In St. Vincent, he says, bank regulators let "numbers of unscrupulous persons" into the business. In Montserrat, he complains, officials became "too greedy," doubling the annual license fees.

Later, WFI brochures say, the "best" location for an offshore bank shifted to Vanuatu, an obscure island nation off the coast of Australia. Now it is in the Marianas.

All this moving around has been confusing to some of WFI's customers. For example, John R. Latourette Jr. of Santa Monica, Calif., complained in 1980 that he paid Mr. Schneider $17,375 for a bank license in St. Vincent and that Mr. Schneider never delivered.

Mr. Latourette sued for fraud in California's Superior Court for Los Angeles. Mr. Schneider replied that he had tried hard to get the bank but had made no guarantees that he would succeed. He sued Mr. Latourette for "intentional infliction of mental distress." The dispute was settled out of court.

A Banker's Inquiry

At about the same time, Theodore R. Simson, a Columbus, Ohio, banker, noticed a WFI advertisement in The Wall Street Journal. He says he wrote that he was interested in buying a bank on Montserrat, but he never got an answer. Finally, he met with Mr. Schneider, but the deal didn't materialize. "He (Mr. Schneider) is in a different world," says Mr. Simson. What Mr. Simson wanted was a real bank; what Mr. Schneider offered seemed to be more like a "tax package," Mr. Simson says.

At any rate, Mr. Simson wound up buying a Montserrat bank license from local authorities, and he now operates the First American Bank, a commercial bank, there. He says he doesn't have any offshore-bank owners as depositors and he suspects there aren't many left in operation on Montserrat. "They just die for lack of paying the annual license fee. That's $8,000 a year. Offshore banking isn't a cheap operation."

Another confusing factor for potential customers is that on at least one occasion the guest speaker featured in WFI advertisements for a seminar failed to show up. Donald C. Alexander, a former IRS commissioner, was supposed to talk about "the IRS attitude toward legal use of offshore banks" at two seminars in July 1981.

Mr. Alexander, now a Washington lawyer, says he initially agreed to give the talk, but decided against it after doing further research on Mr. Schneider and what he was selling. "It was something that I was opposed to," says Mr. Alexander. "I didn't think that they wanted to hear a lecture from a cop."

One of WFI's claims to legitimacy, according to its literature, is that the company is "a highly visible organization because it advertises frequently in The Wall Street Journal . . . ." (WFI has advertised in the Journal off and on during the past five years. However, a Journal representative says the newspaper doesn't knowingly publish advertisements making claims that can't be backed up.)

In 1980, however, the Los Angeles County district attorney sued Mr. Schneider for failing to substantiate claims WFI had made in two advertisements published in the Journal.

To settle the matter, Mr. Schneider paid a $2,500 fine and agreed to a court injunction that permanently restrains him from making any claims that "cannot be substantiated by factual, objective or clinical evidence."

While there are people, Mr. Schneider says, who have made a great deal of money operating his offshore banks, he and his company never disclose the names of clients. "I felt that it was more important for professional purposes to pay the fine," he asserts.

Mr. Schneider says that his own survey of a sample of 16 banks he has sold shows that 38% are profitable. He adds that half have never been put into operation. "Believe it or not, a lot of people buy banks from us and don't use them."

Chairman **Roth**. Do you have the names of those banks, that are profitable?

Mr. **Schneider**. No; I do not, sir.

Chairman **Roth**. But you did make a survey?

Mr. **Schneider**. Yes, sir.

Chairman **Roth**. You don't have them available here?

Mr. **Schneider**. I don't have them available but I can furnish you the information, if you would like.

[The information referred to was not received by the subcommittee at the time of printing.]

Chairman **Roth**. Yes. Out of 16 banks you surveyed out of how many you sold?

Mr. **Schneider**. We sold 120.

Chairman **Roth**. In this article it says, "Mr. Schneider's company has assembled a private stock of 50 licenses and corporate charters of banks on Saipan, the island capital of the Commonwealth of the Northern Marianas.

According to his company's "offering memorandum" he can be persuaded to part with one of them for about $21.000.

First, he has to be sure the buyer comes up with $150,000 for "good character and honesty" and no criminal record.

It goes on to say that "such a bank, according to the memorandum consists mainly of a box of legal documents, preprinted certificates of deposit, letters of credit, stationery and other documents bearing the name of WFI to give the bank an impression of distinction and credibility;" is that a correct statement?

Mr. **Schneider**. I think that is colored by a news reporter to personify——

Chairman **Roth**. Does a memorandum talk about a box of legal documents, printed certificates of deposit?

Mr. **Schneider**. It talks about a set of legal documents. They all have relevance and purpose.

Chairman **Roth**. There is nothing in that memorandum which says "could give the impression of distinction and credibility"?

Mr. **Schneider**. There might be in a section of the memorandum that relates to bank names.

Chairman **Roth**. This is a quote, "Impression of distinction and credibility"?

Mr. **Schneider**. It is out of context, sir, but there is such a quote, statement within the offering of memorandum.

Chairman **Roth**. Does it talk about a box of legal documents?

Mr. **Schneider**. It doesn't say box of legal documents. Those are the reporter's words.

Chairman **Roth**. Further, in this article, it says:

> One of Mr. Schneider's big selling points is the offshore banker can do all this without risking his required $10,000 capital. He can put that in one of Saipan's commercial banks, all of which are insured by the FDIC.

Is that correct?

Mr. **Schneider**. The statement is pulled from context and I don't have the context from which it is pulled so I cannot confirm the accuracy.

Chairman **Roth**. Do you say they are protected by the FDIC?

Mr. **Schneider**. I say, in the context of the discussion of what bank services are available in Marianas, I say there are FDIC banks. I don't say it is a capital that cannot be risked. Certainly if the bank behaves itself in a fraudulent manner, he is risking his capital.

Chairman ROTH. Do you use as another selling point that the U.S. Government has no hand in law making there, American tax and banking laws, and it would ordinarily apply to banks in U.S. States and possessions but do not apply in the Marianas, is that a selling point?

Mr. SCHNEIDER. Yes, sir, and I have factual basis from which I base that statement.

Chairman ROTH. Do you know a Maurice Benjamin?

Mr. SCHNEIDER. No; I do not.

Chairman ROTH. Philip Kitzner?

Mr. SCHNEIDER. No; I do not. I know the names because they were reported in newspaper articles.

Chairman ROTH. How about Kevin Krown, K-r-o-w-n?

Mr. SCHNEIDER. No; I do not.

Chairman ROTH. Do you know whether Robert Vesco owns a private bank?

Mr. SCHNEIDER. To the best of my knowledge, I do not know.

Chairman ROTH. I think that is all the questions we have at this time.

The subcommittee is in recess.

[Whereupon, at 1 p.m., the subcommittee recessed, to reconvene at the call of the Chair.]

APPENDIX

PREPARED STATEMENT OF SENATOR WILLIAM V. ROTH, JR., CHAIRMAN PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

CRIME AND SECRECY
THE USE OF OFFSHORE BANKS AND COMPANIES

March 15, 1983

Today the Permanent Subcommittee on Investigations begins a series of hearings on an issue that we have worked on for two years and one that has frustrated law enforcement for many years: the use of offshore banks, trusts and companies to facilitate criminal activity in the United States.

What we have found during these two years is a problem that is pervasive and growing. It is also complex, because one of its main roots is a clear difference in philosophies. We disdain bank and corporate secrecy to the degree it is practiced elsewhere, whereas secrecy is exalted and protected in other countries--many of them our fiends and allies.

And while we still don't know how much criminal money leaves the country and comes back again, we have collected scores of individual cases involving hundreds of millions of dollars each--evidence enough that the total amount is substantial. For example, one money launderer whose story will be unfolded in these hearings laundered a quarter of a billion dollars in just 8 months.

Neither do we know how much of the billions going offshore is sent abroad to escape the Internal Revenue Service. The IRS itself would like to know.

What, then, are the dangers of all this? The answer, I think, is well stated in the preface to the staff study on offshore banking which has just been released and which I commend to your reading. It says: "Crime offshore poses a threat to the public's safety and confidence in the criminal justice system, stymies the collection of tax revenues, and erodes confidence in the banking system."

Let me hasten to add that we have had some successes. Perhaps the most spectacular have involved the convictions of major money launderers and bank officials and employees who have connived in these schemes. And the Securities and Exchange Commission has reached an understanding with the Swiss on the exchange of information to curb insider trading on securities.

But we must do more.

We must find some way to induce Caribbean countries particularly to open their records to us on U.S. criminals who unfortunately are made welcome there or whose offshore activites are winked at. One way may be through President Reagan's Caribbean Basin Initiative, which at least passed the House in modified form during the last session.

We must amend the law so that Customs agents will be free, upon reasonable cause, to search outgoing passengers who carry excessive amounts of cash to havens like the Caymans and the Bahamas.

We must find some way to frustrate the free-wheeling sale of offshore banks--banks that exist only on paper--to Americans suspected of using these banks for tax evasion in the name of tax protest and for other unlawful purposes.

And we must do more, administratively and legislatively, to improve coordination among the many Federal agencies concerned with this important, perplexing problem.

There is much to be done. And in the staff and consultant studies we have commissioned, in this set of comprehensive hearings about to unfold, the Permanent Subcommittee on Investigations is attempting to lay out the problem in all its parts and to find solutions.

This completes my statement.

Department of Justice

PREPARED STATEMENT OF D. LOWELL JENSEN,
ASSISTANT ATTORNEY GENERAL

CRIMINAL DIVISION
U.S. DEPARTMENT OF JUSTICE

CONCERNING LAW ENFORCEMENT PROBLEMS ARISING FROM FOREIGN BANK SECRECY LAWS AND PROPOSED REMEDIES

BEFORE THE
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

MARCH 15, 1983

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to present the views of the Department of Justice on the serious and complex problems posed by the use of banks and other financial institutions located in foreign countries in connection with criminal activity in violation of United States laws. My testimony today will address our view of the nature and scope of these problems, the measures we have taken to better cope with them, the steps we plan to take to improve our ability to deal with them, and the possible need for the legislative support of Congress to provide us with additional tools to assist our efforts.

For the first fifty years of this country's history, crime was almost entirely a local problem. The slowness of travel and communications effectively precluded any significant amount of interstate criminal activity. Over the following 130 years, as our transportation and communications systems improved, interstate criminal activity became a constantly increasing problem. Congress responded through the passage of a growing number of federal criminal laws designed to permit United States law enforcement authorities to better deal with this problem. While the increase in the level of interstate criminal activity has been an increasing concern, such activity takes place within the borders of the United States; therefore, Congress has the power to grant the Executive and Judicial Branches sufficient authority to adequately investigate and prosecute it, since the investigative powers of the federal criminal investigative agencies and the processes of the federal courts extend throughout the territory in which this criminal activity takes place.

However, with major advances in transportation, communication, and data processing technology in the past fifteen years, the world has effectively become a much smaller place. No longer is it rare to encounter criminal activity affecting the United States which transcends our national borders. Transnational criminal activity is being encountered with ever increasing frequency. For example, in the 1960's the number of extradition requests to and from the United States seldom exceeded twenty per year. By 1978, that number had risen to 100. In 1982, we made or received 338 extradition requests.*/ We fully expect the increase of such requests to continue. Moreover, this increase represents only the tip of the iceberg because the costs associated with international extradition make it useful only in the most important cases. Indeed, while more than two-thirds of the extradition requests made or received by the United States in 1982 related to fugitives wanted for crimes of violence or narcotics offenses, it is clear that non-violent criminal activity which is unrelated to narcotics offenses is becoming an increasing problem, and much of the success of such conduct is directly attributable to bank secrecy laws, as evidenced by the Interconex case, which I will discuss shortly.[*/]

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*/ A summary of fugitive extradition requests for calendar years 1979 - 1982 is included in the Appendix.

While Congress has the authority to confer adequate powers on the other branches of government to cope with the transition from purely local to interstate criminal activity because all such activity occurred in the United States, its ability to provide federal law enforcement authorities and courts with sufficient means to deal with transnational criminal activity is much more circumscribed. We are no longer dealing with one sovereign nation, but with many. The activities of United States investigative agents and prosecutors involved in such cases are regulated not only by United States law, but also by the laws of the countries in which all or part of the criminal activity with which they are concerned took place. And, the effect of United States court orders supporting our efforts to obtain investigative information and evidence is limited to a significant extent by the willingness and ability of affected foreign countries to permit the execution of those orders.

Thus, if we are to deal effectively with such activity, we must enlist the cooperation of the affected foreign countries. No longer is the problem a purely

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[*/] Included in the Appendix is a detailed description of the Interconex case.

domestic one. It has become one which can and does affect our foreign policies and relations, and it is one which has become of increasing concern to the State Department. For example, during the past year, the ability of the Justice Department to obtain information from certain Caribbean based banks which were (and continue to be) used to launder proceeds from drugs and narcotics activities has become a growing issue between the United States and some of those countries which now claim financial dependence on the same banking operations for economic stability.

As this Subcommittee has noted, banks in foreign jurisdictions play a prominent role in international criminal activity affecting the United States. The role of foreign banks in so-called "offshore" bank secrecy jurisdictions is of particular importance.

While banks in certain Caribbean countries are presently playing a significant role in transnational criminal activity affecting the United States, it is a mistake to limit the inquiry to such "offshore" banks. The problem is a world-wide one. Bank secrecy jurisdictions exist all over the world, and their proliferation is continuing. Therefore, resolving our problems with one such country or jurisdiction, can result in criminals merely shifting their activities to other countries or jurisdictions. Moreover, it is a problem involving not only small local foreign banks, but one increasingly involving branches of many of the world's largest banks.

Let me address the noteworthy Interconex case, a case that did not involve drugs or violent crime. Rather, this was a commercial fraud case, the victim was the Raytheon Company - and involved a scheme to defraud the Raytheon Company of more than $2 million. The scheme employed by the defendants related to certain contracts awarded by Raytheon for the fabrication and shipment of modular housing for a major Raytheon air defense project in Saudi Arabia. The defendants paid a bribe of more than $1 million to certain Raytheon employees to guarantee the awarding of shipping subcontracts for the modular housing in Saudi Arabia. These shipping subcontracts contained inflated charges of more than $2 million, which the defendants diverted to a Swiss bank account. These funds ultimately were distributed through a series of complex transactions involving Swiss, Bermuda, Liechtenstein and Cayman Islands banks and companies.

The detailed facts of that case and the indefatigable efforts of the Department of Justice prosecutors demonstrate several salient features that this Subcommittee should not overlook. First, bank secrecy laws can be used improperly to protect commercial swindlers; second, sophisticated criminals use multiple countries with bank secrecy laws to delay and ultimately frustrate legitimate law enforcement investigators beyond the statute of limitations periods and thereby escape prosecution; third, foreign countries rely upon slow, time-consuming and very expensive law enforcement techniques such as letters rogatory at the expense of legitimate and reasonable law enforcement needs.

It is a mistake, however, to condemn bank secrecy, per se, because it is being abused in some countries and jurisdictions. Persons and companies transacting business with and through banks are entitled to a reasonable degree of privacy in connection with such business transactions. The United States itself, through the Right to Financial Privacy Act, recognizes this right. The critical question is not whether a country has bank secrecy laws, but whether the country has built into its laws effective and efficient means of piercing bank secrecy where there is reasonable suspicion that a bank account has been used in connection with a crime or as the depository of the proceeds of a crime.

For example, Switzerland has long been regarded as the model bank secrecy jurisdiction. Yet, through the Mutual Assistance Treaty in Criminal Matters ("Treaty") between our countries and the enactment of appropriate enabling legislation in Switzerland, law enforcement and privacy interests have been placed in proper perspective. In the six years the Treaty has been in force, the United States has made more than 200 requests under the Treaty. More than two-thirds of those requests have asked for, among other things, bank records. The bank records we have obtained under the Treaty have been very instrumental in many important successful prosecutions, and, in many instances, have been cited by judges as the basis for enhancing sentences of convicted offenders.

Because of the effectiveness of the Treaty and the potential effectiveness in general of mutual assistance treaties in criminal matters, we have made the negotiation of such treaties with other key countries an important element of the Justice Department's program to combat transnational crime. A mutual assistance treaty in criminal matters is now in force with Turkey, and treaties with Colombia and the Netherlands (including the Netherlands Antilles) have been advised and consented to by the Senate and are awaiting ratification by our treaty partners.*/ A treaty with Italy was recently signed by Attorney General William French Smith, negotiations with West Germany are nearing conclusion, and negotiations with Jamaica will resume within the next two months.

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*/ Unfortunately these mutual assistance treaties cannot be used for tax or "fiscal" crimes, and thus, because of the unwillingness on the part of foreign countries to grant access to bank records to the U.S. law enforcement agencies investigating tax fraud and tax evasion matters we must seek other avenues for obtaining such information and evidence.

In some instances, we have employed foreign counsel to represent the United States in connection with requests for letters rogatory for bank records. In the past two years, we have obtained bank records from the Bahamas in at least six instances through such use of private counsel. In the *Interconex* case, private counsel was used to successfully obtain bank records from the Cayman Islands.

Despite the successes we have achieved through the use of private counsel, we do not view this costly, time-consuming method to offer a viable, long term solution to the problem of obtaining foreign bank records. This is wholly unsatisfactory and altogether too expensive. It is the position of the Department of Justice that the foreign government should represent the U.S. in its requests for information in foreign courts.

In order to help induce bank secrecy jurisdictions to enter into mutual assistance treaties with the United States, we are considering the feasibility of designing all future treaties in a manner that will permit the forfeiture of narcotics trafficking monies to our treaty partners in whose bank the funds are deposited. The Swiss Treaty, through the operation of Swiss law, permits such forfeiture to the canton in which the bank account is located. Over the past two years, the Swiss have frozen, and are in the process of forfeiting, amounts estimated to be as high as $20,000,000 in narco-dollars pursuant to information provided to them under the Treaty. Given the magnitude of narco-dollar accounts in many bank secrecy jurisdictions, the possibility of such forfeitures should offer a significant incentive to enter into mutual assistance treaties in criminal matters and to implement them in a manner that will be mutually beneficial to both parties.

Where problem bank secrecy jurisdictions fail to reach a reasonable accommodation between bank secrecy and the requirements of bona fide reasonable law enforcement interests, other measures will be aggressively pursued: First, we shall be obligated to resort to the service of subpoenas on the United States branches of banks whose foreign records we seek. This approach was most recently sanctioned by the United States Court of Appeals for the Eleventh Circuit in United States v. Bank of Nova Scotia, 691 F.2d 1384 (11th Cir. 1982). Second, we shall, after careful review by Department of Justice officials in Washington, D.C., subpoena appropriate officers of foreign banks if they enter the United States where they are concluded to be material witnesses. See, United States v. Field, 532 F.2d 404 (5th Cir. 1976). Third, we shall, applying comparable standards and review within the Department, subpoena attorneys and agents for foreign corporations who travel into the United States involved in money laundering schemes to testify and to produce records of the corporations. United States v. Bowe, 694 F.2d 1256 (11th Cir. 1982).

Until we can obtain the level of cooperation from other bank secrecy jurisdictions which we have obtained from the Swiss and certain other countries, foreign bank secrecy laws will enable criminals to successfully avoid indictment and prosecution in the United States. The problem presented by the use of banks in such bank secrecy jurisdictions is particularly acute in connection with financial investigations of high level narcotics traffickers and financiers who use banks in such jurisdictions to launder the astronomical profits they make from preying on our society. Many narcotics financial investigations have been frustrated by the invocation of bank secrecy laws. Such use of bank secrecy laws plainly frustrates law enforcement agencies which seek only to protect the public from such criminals and thus, unreasonable bank secrecy should not be tolerated by the international community.

In addition to frustrating major narcotics investigations, the improper application of foreign bank secrecy law has also played a substantial role in obstructing the investigation of numerous fraud schemes using banks in such jurisdictions as instrumentalities in carrying out such frauds or as facilities for laundering their proceeds. Finally, as Assistant Attorney General Archer and Commissioner Egger will testify, banks in these jurisdictions are being increasingly used in numerous criminal tax fraud and tax evasion schemes, and, as already described, constitute a focus joint criminal and tax investigations of international narcotics traffickers. Their testimony will deal in depth with these matters.

The predominance of the foreign bank secrecy problem in discussions of transnational law enforcement problems affecting the United States should not obscure the need for us to take other steps to improve the effectiveness of United States law enforcement efforts in this area. Many of these improvements can be accomplished without legislation.

First, in an effort to improve coordination of our overall federal effort, the Department of Justice recently sponsored a highly successful conference on obtaining evidence from foreign jurisdictions among senior level federal prosecutors and investigators, almost all of whom had significant experience in international investigations, to discuss their activities, the successes they had achieved, and the problems they had encountered in conducting those investigations.[*/] Based on the success of this conference, we anticipate holding future conferences on obtaining evidence from foreign jurisdictions on a regular basis.

Second, many impediments to the successful investigation of international criminal activity affecting the United States may be overcome through changes in agency rules and regulations without the need for new legislation. For example, much of the clearing of transactions for banks in Caribbean bank secrecy jurisdictions is done by correspondent banks in the United States. However, there is no requirement that such correspondent clearing banks file a report with any of the bank regulatory agencies as to the foreign banks for which they are acting in this capacity. Identifying such correspondent banks would enable us to pick up many transactions of investigative interest without having to seek the records of the foreign bank itself.

[*/] Agencies participating in at the Conference were the Federal Bureau of Investigations, Drug Enforcement Administration, Internal Revenue Service, U.S. Customs Service, Postal Inspection Service, U.S. Marshals Service, Comptroller of the Currency, Federal Reserve Board, U.S. Interpol National Central Bureau, Security Exchange Commission, and Department of Commerce.

Finally, in response to the Subcommittee's specific request for suggestions, there are a number of areas in which legislation may be appropriate in order to assist the efforts of United States law enforcement authorities in combatting and investigating international criminal activity affecting this country. Neither the Department nor the Administration is formally recommending specific legislation, but some areas for discussion are:

1. Further removing obstacles to information sharing between federal law enforcement agencies. At present, there are restrictions on United States criminal investigative agencies prohibiting them from sharing critical information about criminal activity which transcends agency jurisdiction.

2. Changing the Federal Rules of Evidence to facilitate the introduction of foreign business records -- particularly foreign bank records-- on the basis of the certification of the custodian of those records, before an appropriate foreign official, that they were kept in accordance with the requirements of Rule 803(6) of the Federal Rules of Evidence. The signature of the foreign official would then be authenticated in accordance with Rule 902(3) or the applicable mutual assistance treaty in criminal matters, and the records would be admissible in United States court proceedings unless the defendant could make a proper showing that there was significant reason to believe the records lacked trustworthiness.

3. Criminalizing attempted violations of the Bank Secrecy Act with respect to exportation of currency and monetary instruments from the United States, and specifically authorizing customs searches of persons and property leaving the United States.

4. Increasing penalties for failure to report the import or export of currency and monetary instruments, and for the failure to report beneficial interests in foreign bank accounts on income tax returns.

5. Amendment of statute of limitations provisions to exclude time required to obtain foreign evidence when there is a showing that the defendant made use of the foreign jurisdictions in committing an offense.

6. Enact federal legislation:

   a) to authorize expressly the issuance of requests for international judicial assistance when it is shown that relevant evidence exists abroad;

   b) to require defendants to pay the costs of obtaining evidence abroad when it is there due to actions of the defendant;

c) to require that any objections to requests for foreign judicial assistance be filed with the trial court and not in the foreign courts;

d) to authorize U.S. District Judges to attend foreign depositions proceedings or, in the alternative, to appoint special masters as provided in Federal Rule of Civil Procedure 53;

e) to provide that a deposition taken in a foreign country and recorded in a manner other than a verbatim record is not inadmissible simply because it is not verbatim.

7. Modify costs statutes to authorize the trial court to impose on defendants costs of investigation as well as prosecution.

8. Consider amendment of the Speedy Trial Act to designate as excludable time the period between the issuance of a request for international judicial assistance and its execution by the foreign judicial authority or until such time as the issuing court determines that there is no reasonable expectation of receiving such assistance.

The tremendous growth in the importance of international criminal activity in the United States is a relatively recent phenomena. The Department of Justice is fully aware of the magnitude of this problem, and intends to play a leadership role in developing measures and programs to effectively deal with it. Such measures and programs, of course, will be significantly dependent on Congressional support. In this respect, we are very pleased with this Subcommittee's interest in the problem and the fine work it and its fine staff are doing.

EXTRADITION: FUGITIVES REQUESTED BY CATEGORIES OF CRIMES

Source of Request	Category of Crimes	CY 1979		CY 1980		CY 1981		CY 1982	
		#	%	#	%	#	%	#	%
Foreign	Violent*	18	25.4	28	28.3	32	27.4	38	37.6
	Narcotics	22	31.0	25	25.3	28	23.9	28	27.7
	Violent & Narcotics	40	56.3	53	53.5	60	51.3	66	65.3
	White Collar	30	42.3	31	31.3	49	41.9	32	31.7
	Other	1	1.4	15	15.2	8	6.8	3	3.0
U.S. Federal	Violent*	6	11.1	25	28.4	16	15.2	28	16.3
	Narcotics	27	50.0	22	25.0	37	35.2	80	46.5
	Violent & Narcotics	33	61.1	47	53.4	53	50.5	108	62.8
	White Collar	15	27.8	26	29.5	42	40.0	62	36.0
	Other	6	11.1	15	17.0	10	9.5	2	1.2
U.S. State	Violent*			34	50.7	42	53.8	56	65.1
	Narcotics			6	9.0	9	11.5	10	11.6
	Violent & Narcotics	**	**	40	59.7	51	65.4	66	76.7
	White Collar			20	29.9	24	30.8	19	22.1
	Other			7	10.4	3	3.8	1	1.2
All	Violent*	24	19.2	87	34.3	90	30.0	122	34.0
	Narcotics	49	39.2	53	20.9	74	24.7	118	32.9
	Violent & Narcotics	73	58.4	140	55.1	164	54.7	240	66.9
	White Collar	45	36.0	77	30.3	115	38.3	113	31.5
	Other	7	5.6	37	14.6	21	7.0	6	1.7

* Violent Crimes include: homicide, rape, kidnapping, explosives and weapons offenses, terrorists offenses, air piracy, arson, destruction of property, obstruction of justice, extortion, robbery, etc.

** Handled by Legal Adviser, Department of State. No records or statistics kept.

NOTE: A fugitive whose extradition was sought for more than one crime category is counted as a multiple statistic for purposes of this chart.

RAYTHEON COMPANY DEFRAUDED

A Classic Multinational Fraud Case

During the investigation and prosecution of a recently concluded commercial bribery case the Department of Justice sought evidence and investigative assistance from four foreign jurisdictions:

Switzerland;
Liechtenstein;
Bermuda; and
the Cayman Islands, B.W.I.

While these requests met with widely varying degrees of cooperation from the foreign authorities, the assistance that ultimately was provided proved crucial to the completion of the investigation and to the successful prosecution of the defendants.

In essence, this case involved a commercial bribery scheme in which the two principals of a shipping company bribed two employees of a customer company to obtain shipping contracts with shipping charges inflated by approximately $2 million. The customer, the victim of this scheme, was the Raytheon Company. The funds from these inflated charges, the scheme proceeds, first were diverted to a Swiss bank account nominally held by a Liberian shell corporation. In fact, the Liberian corporation was controlled by the shipping company principals through a Swiss attorney in Geneva. The diversion of the funds to the Swiss account thus enabled the defendants to conceal and disguise the existence and subsequent distribution of the scheme proceeds.

The defendants caused approximately $1 million of the scheme proceeds to be transferred by means of checks to another Swiss account held in the name of a Liechtenstein entity and to two bank accounts in the Cayman Islands. This Liechtenstein entity was controlled by the two recipients of the bribes through a Geneva attorney and a Liechtenstein attorney. The Cayman Islands bank accounts were held by two Cayman Islands companies, each of which was controlled by the bribe recipients.

The bribers' share of the proceeds, approximately $1 million, was transferred to another Swiss account held by a Liechtenstein entity that they controlled and then, by wire transfers, to a Bermuda bank account in the name of a Cayman Islands company they owned. At least some of the these funds were then "laundered" by means of sham loan arrangements involving a Netherlands bank; in these loan arrangements the funds were used to secure loans to the defendants.

A. Switzerland

The Swiss Treaty request filed under the United States-Swiss Treaty on Mutual Assistance in Criminal Matters was the most complex and time-consuming for the Department of Justice prosecutors. In all, nearly three years were spent in pressing this request before all of the essential items of evidence were obtained.

The formal request, which asked chiefly for bank account records, was filed with the Swiss Central Authority in September of 1978. On November 3, 1978, the targets of the investigation caused an "opposition" to be filed with the Swiss authorities in which objections were raised to the execution of our request. Thereafter, we filed both a response to the opposition brief as well as a supplemental request, which asked that a Swiss lawyer, whom we had just identified, be deposed about his activities in the fraud scheme.

The Swiss Central Authority consolidated the original and supplemental requests and on April 10, 1979, rejected the oppositions filed against each of our requests. Pursuant to the Swiss implementing legislation, the opposing parties were granted thirty days in which to appeal the decision to the Swiss Federal Court and during this period appeals were filed. On August 8 the Swiss Federal Court began its deliberations on this matter and on September 28 it rejected the appeals; however, the implementing legislation provided for appeal to a special "consultative" commission and the opposing parties were granted leave to file their appeal briefs.

The president of the consultative commission set the meeting of the commission for July 9, after which the appeals were rejected by a commission decree of August 26; the opposing parties then filed an administrative appeal with the Swiss Federal Council, a body somewhat akin to our federal Cabinet.

The Federal Council formally rejected the appeals on February 11, 1981, and on February 17 the Swiss Central Authority dispatched documents and testimony gathered pursuant to our request. Many of these documents had been redacted to remove the names of certain allegedly uninvolved third parties.

In early May 1981 the Swiss Central Authority issued decrees denying the objections of three "uninvolved" parties to disclosure of their identities in certain of the bank account documents. The parties thereafter filed appeals with the Swiss Federal Court. In mid June the objection of a fourth party was denied; this decision likewise was subsequently appealed to the Federal Court. In the meantime, during mid May, the Department of Justice prosecutors attended the re-examination of the Swiss lawyer in Geneva. Although this deposition was much more fruitful, principally because the prosecutors were there to press the questioning, the Swiss lawyer refused to answer several crucial questions on grounds of attorney-client privilege.

Upon their return to the United States the prosecutors, acting through the U.S. Central Authority, the Office of International Affairs in the Department of Justice's Criminal Division, requested the Swiss Central Authority to cause the attorney-client assertion to be adjudicated and to compel the lawyer to answer the questions or face contempt. This request was relayed to the examining magistrate.

Near the end of July 1981 the Department of Justice prosecutors were faced with a serious problem. The statute of limitations would run in late September on the first, and perhaps strongest, counts of the proposed indictment. The appeals of the four "uninvolved" parties were still pending before the Swiss Federal Court and there had been no adjudication of the attorney-client claim.

Thus in late August the prosecutors and a member of the U.S. Central Authority returned to Switzerland for the additional depositions. As had been hoped, just as the depositions got underway the Federal Court issued its decrees rejecting the appeals of the four opposing parties. Thereupon the Swiss Central Authority identified each of the parties and handed over unredacted copies of documents relating to them. In addition, we also obtained original checks from the primary bank account.[1] Because the appeals were rejected at the early stages of the depositions, we were permitted to include in our questions references to the previously unidentified parties and thereby obtain significant evidence as to their complicity in the scheme and the ultimate disposition of the scheme proceeds. Although the Swiss lawyer continued to assert the attorney-client privilege, the Department of Justice prosecutors were successful in extracting from him, under intense questioning, much of the information that he was trying to shield.

The evidence obtained during this trip was presented to a federal grand jury in early September and an indictment was returned on September 10, 1981, approximately ten days before the statute of limitations was to run out on the first counts. Although we pressed the Swiss authorities to adjudicate the validity of the Swiss lawyer's assertion of the attorney-client privilege, there was never any adjudication of this issue. Thus the targets of the investigation succeeded in preserving their anonymity in the scheme transactions carried out by their Swiss lawyer and, as a consequence, the Department of Justice prosecutors were compelled to rely soley on circumstantial evidence to implicate the defendants in the Swiss transactions.

After the indictment of this case, depositions of the Swiss witnesses were taken in Switzerland for use at trial. Again, however, the Swiss lawyer refused to answer certain key questions on grounds of attorney-client privilege and again we were unable to obtain an adjudication of this issue by the Swiss judicial authorities.

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[1] Fingerprint analysis identified a defendant's fingerprint on one of the checks obtained from the Swiss bank account.

B. Liechtenstein

After indictment, and at the government's request, a letters rogatory application was issued to the judicial authorities of Liechtenstein by the U.S. District Court for the District of Columbia, the Honorable Norma Holloway Johnson presiding. Shortly after the application was filed, a Liechtenstein court granted the requested assistance and during August 1982 the Liechtenstein witnesses were deposed in Vaduz, Liechtenstein. This testimony and related documentary evidence produced at the time of the depositions were introduced at trial by the government.

C. Bermuda

As British Colonies, both Bermuda and the Cayman Islands follow the general British practice of denying requests for investigative assistance in the pre-indictment stage of a case. Once the indictment was returned, however, our letters rogatory request for Bermuda was issued by our trial court. The attorney general of Bermuda received the letters rogatory papers and filed these with the court in Bermuda, which quickly granted the requested assistance. The subsequent deposition proceeding produced significant testimony and documentary evidence that was used at trial.

D. Cayman Islands

Our post-indictment experience with the Caymanian authorities was in marked contrast to the assistance rendered in Bermuda. Shortly after the indictment was returned, we learned that a businessman from the Cayman Islands, who had been associated with the defendants, was visiting in the United States. This individual was served with a subpoena and within a short time his U.S. counsel advised us that he would comply with the subpoena. At the same time, counsel requested that the we assist the witness in obtaining from the Cayman Islands Grand Court a release from the provisions of the Cayman Island business and professional secrecy act. We agreed to do so provided the application for release did not produce unreasonable delay. In early October 1981 the case prosecutors met with the attorney general of the Cayman Islands and provided him and his associates a comprehensive three hour briefing on the case. After the briefing, the attorney general indicated that he was satisfied that we had a prima facie fraud case and that, as amicus to the Grand Court, he would advise the court that he had no objections to the witness' testifying in the United States. On the next day, the Grand Court issued an order permitting the witness to testify. Subsequently, the witness appeared in the United States and testified.

Based on this positive precedent and with the approval of the Caymanian authorities, we filed with the Cayman Islands government a formal request under their business secrecy law. In the request we asked for assistance in obtaining bank records, local company records and testimony of witnesses in the Cayman Islands. The request was approved by the appropriate officials and by the executive committee of the legislature, which authorized the police to gather the requested evidence. At this point, however, complications developed. The banks refused to produce any documents unless compelled to by court order. The attorney general notified us that he could seek such orders only if we filed letters rogatory.

We immediately prepared and submitted to the trial court a letters rogatory request, which was promptly issued by Judge Johnson. Unfortunately, the Cayman Islands attorney general indicated that his office, for various reasons, could not assist in filing the request with the Grand Court. Instead, he advised that we would be required to retain local counsel to represent the United States in this matter.

Eventually we retained both local Cayman counsel and another attorney whose practice involved extensive litigation in the courts of several Caribbean countries including the Cayman Islands. Through our retained counsel we then filed the letters rogatory application. After several hearings the Cayman Grand Court denied, in substance, the request for judicial assistance. On the advice of our private counsel we appealed this decision to the Cayman Court of Appeal.

After lengthy hearings in which the Cayman government argued in opposition to our request, the appeals court, in a landmark decision, granted the letters rogatory application, piercing for the first time Cayman bank secrecy. Thereafter, in July 1982, the Cayman bank officers and business agents named in the request appeared at deposition proceedings in Grand Cayman, produced documents including bank account records, and were deposed. The Cayman evidence thus obtained established a vital link in the chain of proof required for this prosecution.

Observations and Conclusions

This prosecution is noteworthy in several respects. First, the Department's success in obtaining an order from the Cayman Court of Appeal, piercing Cayman bank secrecy for the first time in a foreign prosecution, establishes a valuable precedent for future requests to the Cayman courts for assistance in other United States prosecutions. The Cayman Court of Appeal order also marks the first time that videotaping of depositions has been authorized in the Cayman Islands.

This case also highlighted a potentially serious problem regarding the United States-Swiss Mutual Assistance Treaty. The Swiss Treaty request filed in this case was the first such request to have been litigated through every level of appeal provided in the Swiss domestic implementing legislation. This lengthy appeals process consumed almost two and one-half years and very nearly extended the investigation past the applicable statute of limitations.

Particularly well illustratated in this case are the benefits enjoyed by defendants who employ foreign bank secrecy jurisdictions and other "offshore" transactions in their schemes:

1) Evidence concerning foreign transactions is difficult to obtain in admissible form;

2) Obtaining foreign evidence is time consuming; and

3) Obtaining foreign evidence is an expensive process.

This completes my statement, thank you.

Department of Justice

PREPARED STATEMENT OF GLENN L. ARCHER, JR.,
ASSISTANT ATTORNEY GENERAL

TAX DIVISION
U.S. DEPARTMENT OF JUSTICE

CONCERNING LAW ENFORCEMENT PROBLEMS ARISING FROM FOREIGN BANK SECRECY LAWS AND PROPOSED REMEDIES

BEFORE THE
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

MARCH 15, 1983

Mr. Chairman and members of the Subcommittee:

Thank you for the opportunity to appear before you and present the views of the Tax Division regarding the use of offshore banks and other foreign entities by United States citizens. We welcome these hearings in light of the increasing misuse of offshore jurisdictions in order to circumvent domestic law, including our tax laws.

At the outset, I would like to place the role of the Justice Department's Tax Division in perspective. The detection, selection and development of criminal tax cases is primarily the responsibility of the IRS. The Tax Division is responsible for authorization of prosecutions and grand jury investigations of tax offenses and supervision over prosecutions and investigations conducted by the United States Attorneys.

In a number of cases, the Tax Division assumes responsibility for conducting the grand jury investigation or prosecution. These cases often involve offshore transactions. Our staff also works closely with the Criminal Division, particularly the Office of International Affairs, in treaty negotiations and advises the Treasury Department's International Tax Counsel concerning exchange of information provisions of tax treaties. In addition, we assist United States Attorneys with regard to foreign information gathering and evidence problems, including the initiation of formal requests under tax conventions and mutual assistance treaties.

The use of offshore banks, corporations, trusts and other entities located or formed in foreign countries for illegal activities creates some of the most difficult and vexing problems facing those of us in tax enforcement and litigation today. These cases include the laundering of profits from both legal and illegal business activities and the use of nominee entities and fictitious transactions to create tax shelter deductions or to promote various tax protestor schemes. The money laundering problem is not, of course, confined to the tax area -- it impacts on the enforcement of many other areas of criminal priority, such as narcotics trafficking, securities fraud, and organized crime. Overall, money laundering has become one of the most important and vital aspects of criminal activity generally.

In solving crimes involving offshore banks, the investigator and prosecutor are faced with several significant difficulties: first, discovering where and when money laundering, fictitious transactions and sham entities have occurred or been used; second, obtaining sufficient information and leads to follow the complex schemes that are employed; and, third, securing documents, testimony and other evidence that will be admissible in court to prove the criminal violations. Enormous resources, both investigative and prosecutorial, must be committed to ferret out and convict the perpetrators of these unlawful offshore activities and, in the case of tax crimes, additional resources are necesary to proceed with the audits and investigations necessary to determine civil tax liabilites and thereafter to collect such liabilities.

Following hearings before the Ways and Means Subcommittee on Oversight in 1979, the Commissioner of Internal Revenue, the Assistant Attorney General, Tax Division, Department of Justice, and the Assistant Secretary of the Treasury (Tax Policy) asked Richard A. Gordon to accept an appointment as IRS Special Counsel for International Taxation and to conduct an in depth study of the tax haven problem. In January, 1981, Mr. Gordon submitted a report entitled "Tax Havens and Their Use by United States Taxpayers--An Overview" that has come to be known as the "Gordon Report." A principal finding of the Gordon Report was that despite the Government's efforts to curtail the use of offshore tax havens for tax evasion and avoidance purpose,

> legal and illegal use of tax havens appears to be on the increase . . . by taxpayers ranging from large multinational companies to small individuals to criminals [who] are making extensive use of tax havens.

The Gordon Report also found that tax havens thrive largely due to the presence of foreign banks, the prime subject of this Subcommittee's hearings.

Despite these findings, too few people, both in and out of Government are adequately informed of the pervasiveness of the use of tax haven countries for money laundering and other illegal activities. As in many areas, and I think this is one of them, it is frequently difficult to combat a crime problem without a strong public awareness and concern.

In view of its dimensions, it is ironic that this problem has not received more attention. Reliable overall statistics on money laundering and fictitious transactions for tax evasion are not available, but the best estimates are that we are not dealing with millions of dollars or hundreds of millions or even a few billions. The scope of the problem is probably in the many billions of dollars annually.

An indication of the scope of the problem is suggested by statistical information gathered by the Federal Reserve System of net cash surpluses flowing into or out of particular areas. In Miami, the net cash surpluses had grown dramatically as drug trafficking become widespread and prevalent in the area. An enforcement project in Florida directed at money laundering, called Operation Greenback, in which the IRS, the Justice Department and other agencies participated, caused some dramatic shifts. In an adjacent area, for example, the net cash surpluses grew from 304 million to 835 million in a single year. It is believed that this increase occurred due to the diversion of funds from Miami as the result of the success of Operation Greenback.

Looking at it another way, the small island of Anguilla not more than three years ago had only three banks, but today reportedly has 96. Of the 96, only one apparently has a vault. Paper banks in the Mariana Islands, a U.S. Trust Territory, are being actively marketed in the United States. Brokers of these banks often intimate, without specifically stating, that these offshore banks can be used for illegal purposes or concealment.

As an illustration, one piece of promotional material advertises the advantages of being the first on the block to own your own bank. It describes a means of increasing net worth by recycling of funds and concludes -- and I quote: "Theoretically this process may be recycled over and over again; however, its overall effect after several recyclings would appear fraudulent. Therefore, this technique should be used like sugar in coffee, very sparingly."

Many other examples could be cited, including prosecutions by the Criminal Division, the Tax Division and the United States Attorneys in a myriad of specific money laundering, fraud, tax evasion and other criminal schemes, including those of tax protestors who engineer sham transactions through the sale of "common law trusts" established through offshore banks which they own or control. Suffice it to say that the scope of the tax haven problem is huge and that the efforts to combat it, while significant, important and increasing, have to date not reached a desirable and necessary level. I understand that all law enforcement components in Government dealing with these problems believe that the use of offshore banks and other entities for illegal activities continues to grow.

There are a number of current initiatives and developments to confront and attack the offshore problems. Many of these are encouraging. But the concealment, the wide variety of uses made of offshore jurisdictions and their laws, and the size and complexity of many of the transactions make our efforts at this time seem small and inadequate by comparison.

As I indicated before, an awareness of the problems is a vital first step in confronting the many illegal activities involved. The public, the Congress, others in Government not directly involved in law enforcement, and the media, all need further education and enlightenment. Hearings like this serve an extraordinarily useful purpose in this regard.

In the closely related area of narcotics trafficking, the President and Attorney General Smith have adverted to the offshore money laundering problem. They have created the Drug Task Forces not only to interdict and stem the importation and distribution of narcotics in this country, but also to take the profit out of this invidious business. Thus, many of the investigations and prosecutions by the Task Forces will be directed at large scale and organized groups, with particular emphasis on their financial dealings and financial backers.

With respect to the offshore evidence gathering problems, there are also new initiatives being undertaken. Recently, our Division in conjunction with the Criminal Division and the Executive Office of United States Attorneys held an extremely productive conference on obtaining evidence from offshore jurisdictions for criminal purposes. We brought together for the first time a large representative number of prosecutors with experience in obtaining foreign-source evidence. We also included representatives from all of the investigative agencies in Government that are encountering criminal activity involving the use of foreign banks, trusts and other entities. These agencies included the FBI, DEA, Customs Service, IRS Criminal Investigation Division, SEC, the Federal Reserve, Comptroller of the Currency, Postal Inspection Service, and U.S. Marshals Service. And we plan to hold further conferences of this type to coordinate activities and to seek administrative and legislative solutions to the offshore problem.

The President's Caribbean Basin Initiative legislation could provide a major breakthrough against bank and commercial secrecy in the Caribbean. The legislation contains provisions that countries in that area must relax secrecy through the negotiation of effective bilateral agreements with the United States before certain U.S. tax benefits would become available. Based on the recognition that the economies of many of these countries are highly dependent upon American tourist trade, that legislation would extend the convention tax deduction rule to Americans attending business seminars and conventions in those countries which had a bilateral agreement in place.

The bilateral agreements contemplated by the Caribbean legislation are not the ordinary exchange of information clauses now contained in our tax treaties. Rather, the agreements would be similar to mutual assistance treaties insofar as tax matters are concerned. Both civil and criminal tax information would be covered and the information turned over would have to be in a form usable as evidence in a court proceeding. Of course, not all of the Caribbean countries with bank and commercial secrecy laws are dependent on tourism, but this legislation certainly is a large step in the right direction. It is important that tax, economic and other pressures be brought on all tax haven countries in a coordinated way if the use of offshore jurisdictions for U.S. criminal activities is to be curbed.

Another development is the effort to include stronger exchange of information provisions in tax treaties being negotiated by Treasury Department officials. We in the Justice Department are particularly pleased with the coordination and cooperation we are receiving from the Treasury Department. Both the Tax and Criminal Divisions have been provided the opportunity to assist Treasury in formulating policies and specific treaty provisions. We are hopeful that some of these negotiations may result in exchange of information provisions that will increase the information and evidence available for prosecuting tax crimes.

As described in detail by Assistant Attorney General Jensen, efforts are also being made to negotiate mutual assistance treaties.

With respect to tax offenses, a principal source of information is the informational reports required by the Internal Revenue Code. Unless the participants in the international transaction are required by law to supply the information, and do supply the information when it is required, the transaction often remains undetected. The Government also needs to improve its analysis of information already available to insure that international transaction information gaps do not exist. Additionally, we must continually alert our investigators and prosecutors to the sources of available information. The Tax Division believes that careful study ought to be given to the creation of a single list of sources of information about foreign transactions that is currently available within the Government.

Some recent decisions involving the enforcement of summonses issued by the IRS and grand jury subpoenas in tax cases indicate, I believe, that some progress is being made through litigation concerning offshore evidence problems.

The most important cases in a tax context are United States v. Vetco, Inc., 644 F. 2d 1324 (9th Cir., 1981) decided by the Ninth Circuit in 1981, and In re Grand Jury Proceedings, United States v. Bank of Nova Scotia, 691 F. 2d 1384 (11th Cir., 1982) decided by the Eleventh Circuit last November. In Vetco, the court upheld the enforcement of an IRS summons issued to Vetco for records of its Swiss subsidiary. Vetco argued that compliance would require the Swiss bank to violate Swiss secrecy laws which make it a criminal offense to disclose business records. The court applied the balancing test set forth in the Restatement of the Law of Foreign Relations and concluded that the strong American interest in collecting tax and prosecuting tax fraud justified an intrusion on Switzerland's interest in preserving secrecy of such records.

In the Eleventh Circuit decision in Bank of Nova Scotia, the Government was successful in obtaining bank records from the Nassau branch of a bank that also had a Miami branch on which the subpoena was served. No question of jurisdiction was involved but the bank contended that Bahamian bank secrecy law prevent its compliance and would subject it to criminal liability if it complied. Again, the balancing test was applied and the court's conclusion was that the investigatory function of the U.S. grand jury outweighed the Bahamian secrecy interest.

These cases are important where there is a contact in the U.S. sufficient to support the summons or subpoena. Problems with corporations or other entities in offshore jurisdictions arise, however, where they have no U.S. contact through parent or subsidiary or by doing business or otherwise being present in the U.S. Thus, these decisions, while a step in the right direction, will not solve all of the problems. Indeed, the path toward a comprehensive solution is not through the courts, but rather through negotiation of treaties and the exchange of information agreements for law enforcement purposes generally and for tax cases in particular. While there has been some progress in that area as well, more can and will be done. Yet as long as governments provide annonimity for criminal transactions by maintaining strict confidentiality of bank and corporate records, permitting anonymous corporate ownership through bearer shares or nominees, and promoting these "benefits" for the conduct of illegal activities, we will continue to encounter difficulty in investigating and prosecuting these tax fraud schemes.

In closing, I would like to make the following observations. In testimony last year, I illustrated the complexity of these problems by referring to illegal, widely promoted tax shelters that use fictitious transactions through multiple offshore entities and banks. My conclusion then, and it still is, was that each prosecution of a major scheme in the shelter area involved a major outlay of resources by both the Internal Revenue Service and the Department of Justice in the investigation, preparation and trial of the case. The same can be said of money laundering schemes, offshore "common trusts" created by tax protestors and many other criminal activities we face today. With the advent of easy travel to foreign jurisdictions, the sophistication of planning that goes into these illegal transactions, the proliferation of banks and trusts and other entities to attract ill-gotten gains, and finally the secrecy and concealment that is inherent in these criminal activities, the law enforcement community has a formidable job for which both the tools and manpower are essential.

The potential for damage to our voluntary tax system by the misuse of offshore banks must be recognized and every effort must be made to deal with the offshore problem. Given the ramifications of illegal use of offshore banks and other foreign entities at a time of fiscal austerity and budget deficits, these hearings are timely. I am certain that this Subcommittee will build a record that can result in positive legislative and administrative recommendations to make tax administration and law enforcement more effective.

In order to give the Subcommittee some idea of how offshore transactions are used for tax evasion an Appendix to my statement includes illustrations of tax evasion schemes using offshore banks. In addition, we have provided the Subcommittee with a copy of a recent indictment which shows how an offshore "common trust" scheme was marketed by a tax protestor.

I would be pleased to answer any questions that the Subcommittee may have.

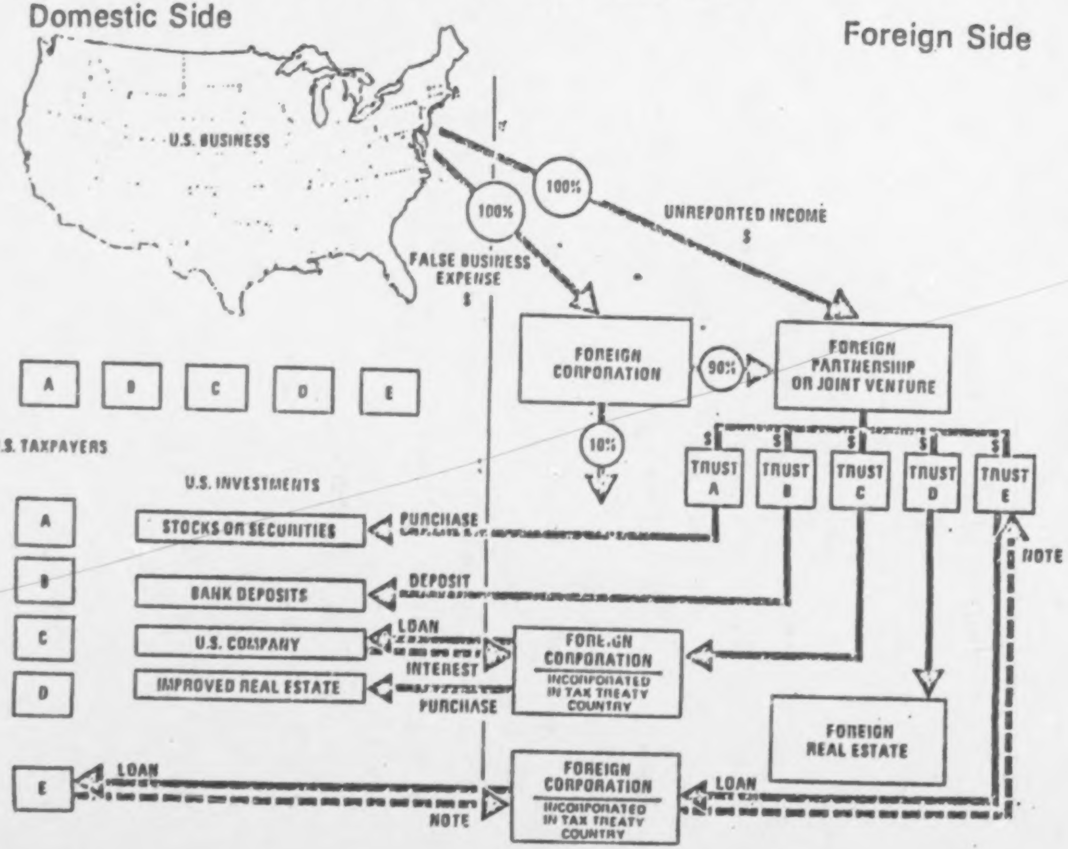
APPENDIX A

TAX HAVEN SCHEMES

The ways in which United States taxpayers use offshore banks to evade taxes are numerous. By either claiming false business deductions or "skimming" business profits, tax evaders secretly "fund" accounts in foreign banks and trusts. For a fee, foreigners often help to conceal the transactions. Repatriation of the untaxed funds takes many forms. The most common ways of repatriation are highlighted in the attached illustration.

The diagram depicts five individuals, A, B, C, D and E, who operate a U.S. business and evade taxes by both false deductions and "skimming." These untaxed funds are "laundered" through a foreign corporation that keeps 10% for its role in providing an ostensible business purpose for the deduction or otherwise assisting in the scheme. The remainder of the funds are deposited in foreign bank accounts controlled by the taxpayers. The secret bank accounts are often listed as assets of a foreign partnership or foreign situs trusts. Each individual uses a different method to enjoy his share of the untaxed funds. In brief, the repatriated funds ostensibly appear to be either legitimate loans or investments made by foreign persons. Provisions of the Internal Revenue Code and tax conventions that provide favorable tax treatment to actual foreign investors are exploited by the tax evaders. As a result, interest income, capital gains on securities and real estate transactions and other similar income escape taxation.

TAX HAVEN SCHEMES


Domestic Side
Foreign Side
U.S. BUSINESS
100%
100%
UNREPORTED INCOME
$
FALSE BUSINESS EXPENSE
$
FOREIGN CORPORATION
90%
FOREIGN PARTNERSHIP OR JOINT VENTURE
10%
A
B
C
D
E
U.S. TAXPAYERS
U.S. INVESTMENTS
$
TRUST A
TRUST B
TRUST C
TRUST D
TRUST E
A
STOCKS OR SECURITIES
PURCHASE
B
BANK DEPOSITS
DEPOSIT
C
U.S. COMPANY
LOAN
INTEREST
FOREIGN CORPORATION
INCORPORATED IN TAX TREATY COUNTRY
D
IMPROVED REAL ESTATE
PURCHASE
FOREIGN REAL ESTATE
NOTE
E
LOAN
NOTE
FOREIGN CORPORATION
INCORPORATED IN TAX TREATY COUNTRY
LOAN

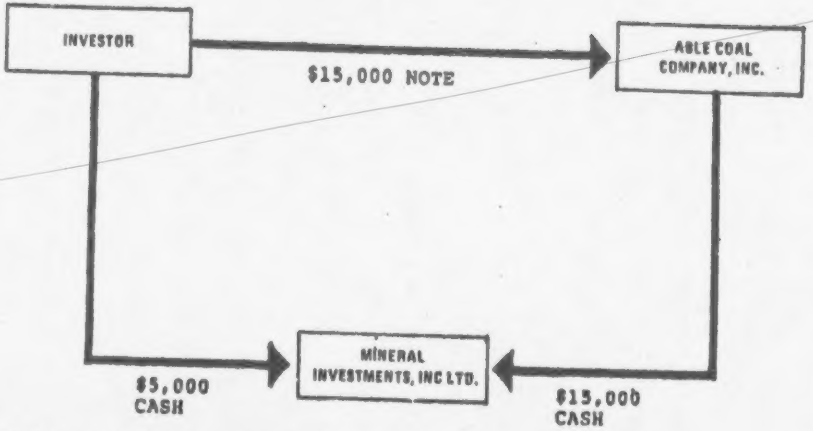
APPENDIX B

TAX SHELTER SCHEMES

Offshore banks are often used as part of illegal tax shelter schemes. A common aspect is a fraudulent "money circle" or "check swap." The tax shelter promoter attempts to create an illusion that deductible business expenses exist or that a depreciable asset has a high cost basis. Foreign entities appear to be the source of loans to finance the expenditures. In reality, either no funds are loaned or the funds actually loaned are insignificant. The entire transaction is a "paper" charade.

To conceal the fraudulent nature of the loan, a circle of entities, all controlled by the promoter, simultaneously negotiate a series of checks. All entities maintain bank accounts at the same offshore bank. None of the accounts has sufficient funds to cover the checks. All checks are negotiated on the same day. Thus, the debits and credits to each account balance. The money circle is complete. The promoter has documentation to corroborate ostensible expenditures. The attached diagrams show, first, the appearance and, second, the reality of a "money circle." To uncover the fraud, the investigator needs access to the offshore banks records.

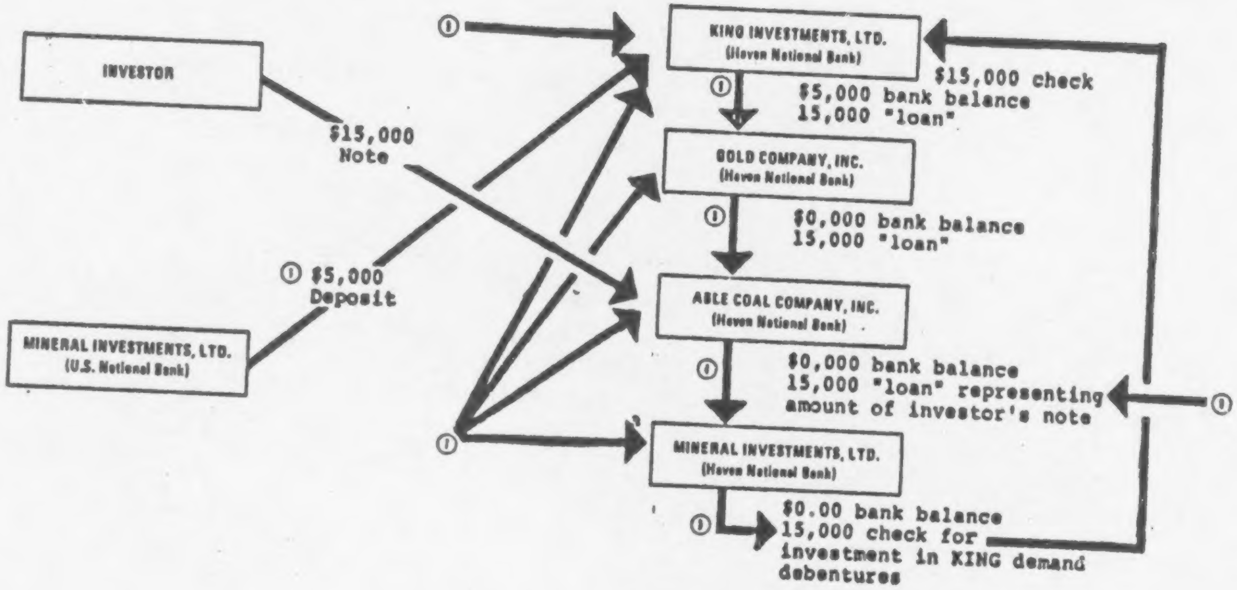
TAX SHELTER
MONEY CIRCLE--ADVANCE MINIMUM ROYALTY PAYMENT


INVESTOR
$15,000 NOTE
ABLE COAL COMPANY, INC.
$5,000 CASH
MINERAL INVESTMENTS, INC LTD.
$15,000 CASH

1. With an initial cash investment of $5,000, the investor acquires rights in mineral leases offered by Mineral Investments, Ltd.
2. Investor is required to make an advance minimum royalty payment of $20.000 as part of the purchase price.
3. Able Coal Company, Inc. loans the investor the additional $15,000 necessary to make his advance minimum royalty payment.
4. Able Coal Company, Inc. pays the $15,000 directly to Mineral Investments, Ltd.
5. The investor claims the entire $20,000 advance minimum royalty payment as a deduction in the current year.
6. The investor is assured by the promoter that he will not have to repay the $15,000 note.

TAX SHELTER
MONEY CIRCLE--ADVANCE MINIMUM ROYALTY PAYMENT

(ACTUAL)


①
INVESTOR
$15,000
Note
① $5,000
Deposit
MINERAL INVESTMENTS, LTD.
(U.S. National Bank)
①
KING INVESTMENTS, LTD.
(Haven National Bank)
$15,000 check
①
$5,000 bank balance
15,000 "loan"
GOLD COMPANY, INC.
(Haven National Bank)
①
$0,000 bank balance
15,000 "loan"
ABLE COAL COMPANY, INC.
(Haven National Bank)
①
$0,000 bank balance
15,000 "loan" representing
amount of investor's note
①
MINERAL INVESTMENTS, LTD.
(Haven National Bank)
①
$0.00 bank balance
15,000 check for
investment in KING demand
debentures

① All four of these entities are owned and controlled by the promoter.

TAX SHELTER
MONEY CIRCLE--ADVANCE MINIMUM ROYALTY PAYMENT

1. Investor's $5,000 cash payment is deposited in King Investments, Ltd's account at Haven National Bank, a bank located in a tax haven country.

2. King Investments, Ltd. issues a check for $15,000 to Gold Company, Inc., a related corporation, despite the fact it has only $5,000 in its account.

3. Gold Company, Inc. issues a check for $15,000 to Able Coal Company, Inc., a related corporation, despite the fact it had a zero balance absent the deposit of King Investments, Ltd's worthless check. This check is purportedly a loan to Able Coal Company, Inc.

4. Able Coal Company, Inc. issues a check for $15,000 to Mineral Investments, Ltd., a related corporation, despite the fact it had a zero balance absent the deposit of Gold Company, Inc's worthless check. This check represents the loan made by Able Coal Company, Inc. to the investor for 3/4 of his advance minimum royalty payment to Mineral Investments, Ltd.

5. Mineral Investments, Ltd, by issuing a check for $15,000 to King Investments, Ltd, completes the money circle. This check is written despite the fact Mineral Investments, Ltd. had a zero bank balance absent the deposit of Able Coal Company, Inc's worthless check. This check is purportedly issued for investment in King Investments, Ltd. demand debentures.

6. All of these companies are owned by the promoter and were organized by him in a tax haven country.

7. All of these companies maintain bank accounts at the same offshore bank.

8. The offshore bank, Haven National Bank, processed the checks even though there were insufficient funds in each account to cover these checks.

9. This money circle was created to give the impression that the $15,000 loan made by Able Coal Company, Inc. to Mineral Investments, Ltd. for the investor's advance minimum royalty payment was a bona fide loan from a non-related corporation.

10. In reality, this purported $15,000 loan on which the investor based his deduction was nothing more than a sham, as this money circle merely created the appearance of a loan. By controlling the companies involved and by using accounts at the same bank on the same day, the promoter devised a ruse that generated cancelled checks and other trappings of loans when, in fact, there were no loans.

PREPARED STATEMENT OF ROSCOE L. EGGER, JR.

COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
SENATE GOVERNMENTAL AFFAIRS COMMITTEE

MARCH 15, 1983

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO BE WITH YOU TODAY TO DISCUSS THE PROBLEMS CAUSED BY OFFSHORE TAX HAVENS AND THEIR ROLE IN MONEY "LAUNDERING" AND RELATED ACTIVITIES, AS WELL AS THE SERVICE'S EFFORTS TO DEAL WITH THESE PROBLEMS. WE APPRECIATE THE OPPORTUNITY TO COMMENT ON THIS IMPORTANT TOPIC, AND TO SHARE WITH YOU OUR INSIGHTS ON THE NATURE OF THE PROBLEM AND SOME OF OUR ACTIONS TO ADDRESS IT.

WITH ME TODAY ARE THE ASSISTANT COMMISSIONER (CRIMINAL INVESTIGATION), RICHARD WASSENAAR, AND THE ASSISTANT COMMISSIONER (EXAMINATION), PERCY WOODARD. WE WILL BE AVAILABLE TO ANSWER ANY QUESTIONS YOU OR THE MEMBERS MAY HAVE AT THE CONCLUSION OF MY STATEMENT.

OVERVIEW OF THE PROBLEM

WHILE I'M CERTAIN THE MEMBERS OF THIS SUBCOMMITTEE ARE QUITE FAMILIAR WITH OFFSHORE TAX HAVENS, I'D LIKE TO TAKE A MOMENT TO BRIEFLY DEFINE THE TERM FOR THE BENEFIT OF ANYONE HERE WHO MAY BE NEW TO THIS AREA.

"TAX HAVENS" HAVE BEEN LOOSELY DEFINED TO INCLUDE COUNTRIES HAVING A LOW OR ZERO RATE OF TAX ON ALL OR CERTAIN CATEGORIES OF INCOME, AND OFFERING A CERTAIN LEVEL OF BANKING OR COMMERCIAL SECRECY. MOST TAX HAVENS ALSO POSSESS MODERN COMMUNICATIONS SYSTEMS, A GENERAL LACK OF CURRENCY CONTROLS, AN AGGRESSIVE POLICY OF SELF-PROMOTION, AND NO EXTENSIVE INVOLVEMENT IN TAX TREATIES.

APPLIED TOO LITERALLY, THIS GENERAL DEFINITION COULD COVER MANY NATIONS THAT ARE NOT ACTUAL TAX HAVENS AND EXCLUDE OTHERS THAT ARE. FOR INSTANCE, SOME TAX HAVENS DO HAVE TAX TREATIES WITH US. HOWEVER, I'M SURE ANYONE FAMILIAR WITH THE SUBJECT "KNOWS ONE WHEN HE SEES ONE", REGARDLESS OF THE EXACT DEFINITION USED. OVER TIME THOSE NATIONS SEEKING RECOGNITION AS "TAX HAVENS" HAVE GENERALLY BEEN SUCCESSFUL IN ATTRACTING THE ATTENTION THEY SOUGHT.

TO HELP SHARPEN THE FOCUS ON THE TAX HAVEN PROBLEM EVEN MORE, THE SERVICE HAS PRODUCED A "TAX HAVEN INFORMATION BOOK", WHICH DETAILS THE DATA AVAILABLE ON SOME 30 TAX HAVEN

COUNTRIES. COPIES HAVE BEEN PROVIDED TO OUR FIELD AGENTS AND OTHER CONCERNED FEDERAL AGENCIES FOR THEIR USE. THIS BOOK IS PROVING TO BE AN INDISPENSABLE REFERENCE TOOL.

FROM THE INTERNAL REVENUE SERVICE'S PERSPECTIVE, THE PROBLEM WITH TAX HAVENS IS CLEAR: TAX EVASION. THE ULTIMATE EFFECT OF THE NUMEROUS SUBTERFUGES AND MACHINATIONS WHICH WILL BE DESCRIBED IN THESE HEARINGS IS TO EVADE TAXES. WHILE WE CANNOT SAY WITH ANY REAL PRECISION HOW MUCH IN TAXES IS BEING LOST THIS WAY, WE DO FEEL CONFIDENT IN SAYING IT'S IN THE MANY BILLIONS OF DOLLARS.

WE SHARE THE SUBCOMMITTEE'S CONCERN ABOUT THE PERVASIVE NATURE OF THIS SITUATION, AND AGREE THAT THE CRIMES INVOLVED ARE FAR FROM VICTIMLESS. AGAIN, FROM OUR PERSPECTIVE, THE REAL VICTIMS IN THIS WIDESPREAD EVASION ARE THE HONEST TAXPAYERS WHO HAVE TO PAY THEIR FAIR SHARE OF THE TAX BURDEN WHILE A FEW UNSCRUPULOUS INDIVIDUALS EVADE THEIR RESPONSIBILITIES. THIS SITUATION IS DECIDEDLY UNHEALTHY FOR OUR VOLUNTARY SELF-ASSESSMENT SYSTEM OF TAXATION AND -- BECAUSE TO A CONSIDERABLE DEGREE THE ACTIVITIES IN THESE TAX HAVENS INVOLVE NARCOTICS TRAFFICKERS AND OTHER ELEMENTS OF ORGANIZED CRIME, ILLEGAL TAX PROTESTERS, AND PROMOTERS OF ABUSIVE TAX SHELTERS -- EQUALLY UNHEALTHY FOR THE ECONOMIC AND SOCIAL STRUCTURE OF OUR COUNTRY AS A WHOLE.

OF EQUAL CONCERN IS THE GROWING NUMBER OF SEEMINGLY LAW-ABIDING PERSONS OF MODERATE MEANS WHO ARE USING OFFSHORE BANKING FACILITIES AND OTHER OFFSHORE ENTITIES AS A MEANS OF TAX EVASION. WE BELIEVE MANY SUCH PEOPLE ARE LEARNING OF THESE TAX HAVENS THROUGH THE EFFORTS OF UNSCRUPULOUS INDIVIDUALS WHO ARE MARKETING TAX SHELTER SCHEMES USING OFFSHORE BANKING FACILITIES, AS WELL AS OTHER CONNECTIONS. THERE IS A KNOWN TREND TOWARD "BROKERING BANKS": THAT IS, FOR A PRICE YOU CAN CREATE OR BUY A BANK FOR THE EXPRESS PURPOSE OF EVADING TAX LIABILITY.

I WANT TO CONGRATULATE YOU, MR CHAIRMAN, AND THE MEMBERS OF THE SUBCOMMITTEE AND YOUR STAFF, FOR YOUR CONTINUING EFFORTS TO FOCUS NATIONAL ATTENTION ON THIS VITAL ISSUE. SIMILAR EFFORTS BY THE LATE CONGRESSMAN ROSENTHAL AND HIS STAFF, WHICH WE UNDERSTAND WILL BE CONTINUED BY THE NEW SUBCOMMITTEE CHAIRMAN, MR. BARNARD, HAVE ALSO PROVEN EFFECTIVE. I BELIEVE THE FIRST STEP IN FINDING SOLUTIONS TO THE PROBLEMS POSED BY OFFSHORE TAX HAVENS IS TO FULLY EDUCATE OTHER MEMBERS OF CONGRESS AND THE PUBLIC AT LARGE ON THE TRUE ROLE THESE TAX HAVENS ARE PLAYING IN THE INTERNATIONAL FINANCIAL WORLD.

THE NATURE OF IRS' PROBLEM

THE INTERNAL REVENUE CODE, AS WELL AS OTHER PORTIONS OF THE UNITED STATES CODE, MAKE IT A FELONY FOR ANYONE TO WILLFULLY

EVADE A TAX IMPOSED BY THE UNITED STATES GOVERNMENT, OR TO INTERFERE WITH THE LAWFUL FUNCTIONS OF THE TREASURY DEPARTMENT IN COLLECTING INCOME TAXES. IN ENFORCING THESE LAWS IN AN INTERNATIONAL SETTING, THE INTERNAL REVENUE SERVICE ENCOUNTERS NUMEROUS OPERATIONAL, LEGAL, AND DIPLOMATIC PROBLEMS. BY FAR THE MOST PRESSING PROBLEM, HOWEVER, IS ACCESSIBILITY TO INFORMATION, OR RATHER A LACK OF ACCESSIBILITY. THE PROBLEM HERE IS NOT SO MUCH ONE OF SUBSTANTIVE TAX LAW, BUT OF GETTING THE INFORMATION TO ENFORCE IT. THE SECRECY PROVISIONS OF OFFSHORE TAX HAVENS CREATE A VEIL WHICH WE OFTEN HAVE GREAT DIFFICULTY PENETRATING IN AN EFFECTIVE MANNER.

LET ME PROVIDE TWO EXAMPLES WHICH I BELIEVE WILL DEMONSTRATE THE NATURE OF OUR INFORMATION PROBLEMS IN TAX HAVEN COUNTRIES.

MY FIRST EXAMPLE IS A SCHEME THAT HAS BEEN SOLD TO A NUMBER OF U.S. PERSONS OPERATING BUSINESSES OR PROFESSIONAL CORPORATIONS. THE U.S. PERSON WOULD TRANSFER A BUSINESS ENTITY TO A DOMESTIC TRUST AND SIMULTANEOUSLY ESTABLISH THREE FOREIGN TRUSTS IN A TAX HAVEN COUNTRY.

FOREIGN TRUST #1 IS FORMED AT HIS DIRECTION BY A FOREIGN PERSON WHOSE ONLY FUNCTION IS TO ESTABLISH AND ACT AS TRUSTEE FOR FOREIGN TRUST #2 AND #3. THE PURPOSE OF ESTABLISHING FOREIGN TRUST #1 IN THIS MANNER IS TO AVOID U.S. FILING REQUIREMENTS ON THE ESTABLISHMENT OF THE FOREIGN TRUSTS.

Foreign trust #2 makes a charge for management services allegedly rendered to the domestic trust (U.S. business) and receives a mangement fee. The fee represents all the profits of the U.S. business. Because this fee is considered U.S. sourced income, foreign trust #2 must file a Form 1040NR to report this income. This return will not show the name of the U.S. business involved. However, this fee income in turn is distributed to a trust #3 and a "contingent royalty fee" deduction is then taken by trust #2. This results in foreign trust #2 having zero taxable income.

Foreign trust #3, having no U.S. sourced income, would not be required to file a U.S. tax return, but ends up with the profits from the U.S. business. To get these profits back to the U.S. person, foreign trust #3, through either "loans" or "gifts," returns the profits to the U.S. person.

Another scheme might involve a foreign parent corporation which has worldwide operations including subsidiaries in the United States, a tax haven country, and a treaty partner country.

The United States subsidiary manufactures goods which are sold to the subsidiary in the tax haven country. Although the goods are sold to the tax haven country, they are shipped directly from the United States to our treaty partner country.

THE SUBSIDIARY IN THE TAX HAVEN COUNTRY WITHOUT ADDING ANY MATERIAL VALUE, RESELLS THE GOODS TO THE THIRD SUBSIDIARY LOCATED IN A TREATY PARTNER COUNTRY AT AN INCREASED MARK-UP IN ITS PURCHASE PRICE, THEREBY, RETAINING A SUBSTANTIAL PROFIT IN THE TAX HAVEN JURISDICTION.

IN THIS EXAMPLE, WE CAN TRACE THE TRANSACTION THROUGH THE U.S. SUBSIDIARY TO THE TAX HAVEN COUNTRY, BUT THERE THE TRAIL ENDS. RECORDS IN THE TAX HAVEN COUNTRY ARE INACCESSIBLE TO US.

FORTUNATELY, IN THIS EXAMPLE, THE ULTIMATE CUSTOMER IS THE SUBSIDIARY IN THE TREATY PARTNER COUNTRY. THROUGH SIMULTANEOUS EXAMINATIONS AND THE EXCHANGE OF INFORMATION PROVISION IN OUR TAX TREATIES, THE PRICE CHARGED THE TREATY PARTNER SUBSIDIARY CAN BE DETERMINED IN COOPERATION WITH THE TREATY PARTNER'S TAX ADMINISTRATORS.

MAJOR IRS ACTIVITIES

THE SERVICE'S RESPONSES TO THE PROBLEMS POSED BY OFFSHORE TAX HAVENS HAVE TAKEN MANY FORMS. IN THE FOLLOWING SECTIONS, I WILL ATTEMPT TO HIGHLIGHT SOME OF OUR MAJOR ACTIONS IN THE CIVIL, CRIMINAL, AND INTERNATIONAL AREAS.

1. Civil

The importance of international enforcement in the Service's examination programs has been increasing. For instance, Examination's International Enforcement Program has made Tax Haven issues its number one priority. Further, tax havens were made a mandatory referral item for international examiners in evaluting participation in an examination.

Examination conducted a number of international seminars to stress the importance of tax haven examinations to group and program managers, and the effort has paid dividends in the form of increased field involvement in this area. Meetings at the Assistant Regional Commissioner and District Director/Regional Commisioner level also stressed these points, and earlier this month a three-day "International Awareness Seminar" for IRS executives focused on current international issues, exchanges of information with treaty partners, and current tax haven schemes.

Our Office of International Operations was recently retitled the Foreign Operations District, and made a line organization under our Mid-Atlantic Region

IN RECOGNITION OF ITS TRUE LINE NATURE. IN ADDITION, INTERNATIONAL EXAMINATION RESPONSIBILITIES WERE DECENTRALIZED. FOUR NEW KEY DISTRICTS AND NINE NEW INTERNATIONAL GROUPS HAVE BEEN ADDED SINCE FY 1980 TO MORE EFFECTIVELY DEAL WITH INTERNATIONAL EXAMINATIONS, ESPECIALLY THOSE WITH TAX HAVEN IMPLICATIONS. THE NUMBER OF INTERNATIONAL EXAMINERS INCREASED FROM 237 TO 293 (19%) BETWEEN FY 1981-1982. SEVERAL NEW AND ENHANCED TRAINING COURSES ON TAX HAVENS HAVE BEEN DEVELOPED, ESPECIALLY IN OUR CONTINUING PROFESSIONAL EDUCATION PROGRAM.

AS I NOTED, THE GREATEST PROBLEM IN INTERNATIONAL EXAMINATIONS IS THE LACK OF EASY ACCESS TO INFORMATION. IN CONJUNCTION WITH OUR TREATY PARTNERS, WE HAVE DEVELOPED TWO MAJOR PROGRAMS TO COMBAT THIS. THE SERVICE ENGAGES IN SIMULTANEOUS EXAMINATIONS WITH FIVE TREATY PARTNERS IN AN EFFORT TO BETTER AUDIT TAX HAVEN TRANSACTIONS. INDUSTRYWIDE EXCHANGES OF INFORMATION ARE ALSO CONDUCTED WITH OUR TREATY PARTNERS TO OBTAIN A MORE COMPREHENSIVE UNDERSTANDING OF SELECTED INDUSTRY PRACTICES, ESPECIALLY THE USE OF TAX HAVENS. THROUGH THESE INDUSTRYWIDE EXCHANGES WITH OUR TREATY PARTNERS, THE SERVICE CAN IDENTIFY POTENTIAL CASES FOR SIMULTANEOUS EXAMINATION, THEREBY TARGETING TAX HAVEN TRANSACTIONS. OUR EXPERIENCE IN

THESE TWO AREAS HAS SHOWN THESE ACTIVITIES TO BE EXCELLENT APPROACHES TO DEALING WITH TAX HAVENS AND OBTAINING INFORMATION OUTSIDE THE BORDERS OF THE UNITED STATES.

THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT (TEFRA) OF 1982 GAVE IRS NEW POWERS TO GET BOOKS AND RECORDS MAINTAINED IN FOREIGN JURISDICTIONS. NEW CODE SECTION 982 PROVIDES THAT IF A TAXPAYER FAILS TO "SUBSTANTIALLY COMPLY" WITH A "FORMAL DOCUMENT REQUEST" ARISING FROM THE TAX TREATMENT OF ANY ITEM, ANY COURT HAVING JURISDICTION OVER A CIVIL PROCEEDING IN WHICH THAT TAX TREATMENT IS AT ISSUE SHALL PROHIBIT, UPON TREASURY'S MOTION, THE INTRODUCTION INTO EVIDENCE BY THE TAXPAYER OF ANY "FOREIGN-BASED DOCUMENTATION" COVERED BY SUCH A REQUEST, UNLESS CERTAIN SUBSEQUENT CONDITIONS ARE MET. THIS SANCTION OF NONADMISSABILITY SERVES TO HELP ENFORCE DOCUMENT REQUESTS IN FOREIGN SETTINGS.

MUCH ALSO HAS BEEN ACCOMPLISHED IN THE USE OF CURRENCY TRANSACTION REPORTS (CTR'S), IRS FORM 4789. IN 1980, THE SERVICE SIGNED AN AGREEMENT WITH THE U.S. CUSTOMS SERVICE THAT PROVIDES FOR THE COMPUTER PROCESSING OF CTR'S BY THE IRS. A COMPUTER TAPE IS SENT TO CUSTOMS FOR INCLUSION IN THE TREASURY

Enforcement Communications System (TECS). A copy of this computer tape is retained by the Service, and all pertinent data from it is included in our Information Return Selection System (IRSS) and the Information Return Program (IRP). Computer-generated transcripts containing CTR information are then associated with individual returns, and those returns which have signficant tax potential are selected for examination.

Examination also has responsibility for conducting checks of secondary financial institutions to ensure their compliance with the recordkeeping and reporting requirements of Title 31. As of December 31, 1982, 4,192 secondary financial institutions were identified by the Service; during FY 1982, we conducted, 1,646 compliance checks on them.

New initiatives in this area include the perfection of CTR data included in IRSS and IRP, which will increase the effectiveness of our association system and generate cases with increased examination potential. We will also be looking into the feasibility of associating CTR data relating to business returns, since the current system utilizes only CTR data on individuals. Finally, we plan to

UTILIZE THE PROGRAMMING CAPABILITY OF THE TECS DATA BASE TO DEVELOP SPECIFIC PROJECTS WHICH CAN BE USED BY AGENTS IN THE FIELD.

FORM 5471, TITLED "INFORMATION RETURN WITH RESPECT TO A FOREIGN CORPORATION", IS A NEW FORM REPLACING SEPARATE FORMS WHICH WERE PREVIOUSLY REQUIRED TO BE FILED. THE FORM, DEVISED IN A JOINT EFFORT BY THE SERVICE AND THE PRIVATE SECTOR, SIMPLIFIES TAXPAYER REPORTING REQUIREMENTS. IT IS ATTACHED TO INCOME TAX RETURNS AND WILL BE USED BY THE SERVICE TO IDENTIFY RETURNS FOR SUBSEQUENT SCREENING OF THEIR EXAMINATION POTENTIAL. PORTIONS OF THE DATA REPORTED ON THIS FORM WILL BE CONVERTED TO MACHINE SENSIBLE DATA WHICH WILL INSURE THAT PROPER EMPHASIS IS PLACED ON RETURNS WITH INTERNATIONAL FEATURES, AND FOR IDENTIFYING U.S. PERSONS WITH TAX HAVEN OPERATIONS. THE FORM IS TO BE USED BY TAXPAYER FILING RETURNS IN 1983.

2. CRIMINAL

OVER THE PAST FEW YEARS, THE SERVICE HAS INCREASED THE TIME SPENT ON INVESTIGATIONS OF NARCOTICS AND ORGANIZED CRIME THROUGH ITS "SPECIAL ENFORCEMENT PROGRAMS" TO SOME 45% OF TOTAL CRIMINAL

INVESTIGATION STAFF TIME. THE SERVICE HAS ALSO INCREASED THE ATTENTION DEVOTED TO THE ILLEGAL TAX PROTESTOR PROBLEM. FURTHER, WE ARE NOW EMPHASIZING BETTER ORGANIZATON FOR TARGETING SUSPECTED DRUG FINANCIERS, PROMOTERS OF FRAUDULENT TAX SHELTERS AND FOREIGN TRUSTS, AND ORGANIZED CRIME FIGURES -- ALL OF WHOM FIGURE PROMINENTLY IN OFFSHORE TAX HAVEN ACTIVITIES.

WE ARE CONVINCED THAT FIRM, POSITIVE ACTION IS NECESSARY IF WE ARE TO EFFECTIVELY ADDRESS THESE PROBLEMS. LET ME GIVE SOME EXAMPLES OF OUR EFFORTS IN THESE AREAS.

AS I TESTIFIED LAST WEEK BEFORE OUR HOUSE APPROPRIATIONS SUBCOMMITTEE, OUR FY 1984 BUDGET REQUEST SEEKS AN ADDITIONAL 220 AVERAGE POSITION AND SOME $12.4 MILLION TO PARTICIPATE IN THE PRESIDENT'S TASK FORCES AGAINST ORGANIZED CRIME AND DRUGS. WE BELIEVE THIS EXPANDED PRESENCE WILL ALLOW US TO INCREASE PRESSURE ON THOSE INDIVIDUALS AND GEOGRAPHIC AREAS MOST IN NEED OF ATTENTION.

BETWEEN 1977 AND 1982, CRIMINAL INVESTIGATION IDENTIFIED 707 CASES WHICH HAD FINANCIAL TRANSACTIONS INVOLVING SOME 90 FOREIGN COUNTRIES. OUR ANALYSIS OF THESE CASES SHOWS THAT:

- 374 CASES (53%) SHOWED INCOME FROM LEGAL SOURCES, (INCLUDING 98 CASES INVOLVING TAX SHELTERS AND 35 CASES INVOLVING ILLEGAL TAX PROTESTERS); AND 333 CASES (47%) SHOWED INCOME FROM ILLEGAL SOURCES (INCLUDING NARCOTIC TRAFFICKING, MONEY LAUNDERING, EMBEZZLING, PORNOGRAPHY, GAMBLING, ETC.);
- THE TOTAL ESTIMATED UNREPORTED INCOME FROM THESE 707 CASES IS OVER $2.6 BILLION.
- 508 CASES (72%) INVOLVED AT LEAST ONE TAX HAVEN COUNTRY;
- THE BAHAMAS, THE CAYMAN ISLANDS, THE NETHERLANDS ANTILLES, PANAMA, AND SWITZERLAND SHOWED UP IN 76% OF THE INSTANCES WHERE TAX HAVEN COUNTRIES WERE INVOLVED;
- 121 CASES (17%) WERE DISCONTINUED OR DECLINED, IN 57 INSTANCES BECAUSE RECORDS FROM FOREIGN COUNTRIES WERE NOT AVAILABLE. OF THESE 57 INSTANCES, 48 INVOLVED TAX HAVEN COUNTRIES.

THE SERVICE IS INCREASING ITS USE OF THE INFORMATION REQUIRED TO BE REPORTED UNDER THE BANK SECRECY ACT (TITLE 31) IN IDENTIFYING TITLE 31 AND TITLE 26 VIOLATIONS. OUR SPECIFIC USES OF CURRENCY TRANSACTION REPORTS (CTR'S), IRS FORM 4789, MAY BE OF INTEREST TO YOU.

In the Araujo investigation, a southern California case involving a large heroin distribution organization was brought to our attention largely as a result of CTR's filed by a small bank near the Mexican border. Araujo operated one of the largest heroin distribution organizations in the country, and made deposits totalling millions of dollars into an account at the bank. This case concluded with Araujo and 16 others being convicted and sentenced on tax and other charges. Araujo's unreported income tax in this case amounted to $13 million.

The Report of International Transportation of Currency or Monetary Instruments (CMIR), Customs Form 4790, is another valuable tool under Title 31. CMIR's are required to be filed by each person who exports from the U.S. or imports to the U.S. currency or other monetary instruments in amounts exceeding $5,000. The forms are processed by Customs, and information from them is included in the Treasury Enforcement Communications System (TECS). The information is accessible through TECS by both Customs and IRS; other law enforcement agencies can gain access to the information by making request of Customs. IRS

CURRENTLY USES CMIR INFORMATION, GENERALLY IN TANDEM WITH OTHER INFORMATION, AS A BASIS TO INITIATE CRIMINAL INVESTIGATIONS AND AS SUPPORTING EVIDENCE IN INVESTIGATIONS ORIGINATING FROM OTHER SOURCES. THERE ARE CRIMINAL AND FORFEITURE PROVISIONS FOR NOT FILING, OR FOR FILING FALSE CMIR'S. THESE PROVISIONS HAVE BEEN VERY USEFUL AND PRODUCTIVE IN OUR JOINT EFFORTS WITH CUSTOMS IN OPERATION GREENBACK.

"OPERATION GREENBACK", AS YOU KNOW, IS A COORDINATED TREASURY AND JUSTICE DEPARTMENT FINANCIAL INVESTIGATIVE TASK FORCE EFFORT TO INVESTIGATE POSSIBLE CRIMINAL VIOLATIONS OF TITLE 31, AND TITLE 26, AND RELATED CHARGES BY INDIVIDUALS DEPOSITING AND WITHDRAWING LARGE AMOUNTS OF CURRENCY AT FINANCIAL INSTITUTIONS IN SOUTH FLORIDA. THIS SORT OF MONEY "LAUNDERING" IS OF PARTICULAR CONCERN TO THE IRS, SINCE ILLEGAL INCOME IS TAXABLE, JUST AS LEGAL INCOME.

IRS AND CUSTOMS HAVE BEEN THE DRIVING FORCE BEHIND OPERATION GREENBACK SINCE 1980. TO DATE, THIS OPERATION HAS REPRESENTED ONE OF THE LARGEST SERVICE RESOURCE COMMITMENTS TO THE INVESTIGATION OF CRIMINAL ACTIVITY IN ONE GEOGRAPHICAL AREA. FOR APPROXIMATELY

2 YEARS WE HAVE MAINTAINED THIS COMMITMENT AT MORE THAN 20 SPECIAL AGENTS. CURRENTLY, WE HAVE 27 SPECIAL AGENTS ASSIGNED TO THE EFFORT, APPROXIMATELY TWO-THIRDS OF THE AGENT FORCE.

OUR JOINT EFFORTS WITH CUSTOMS HAVE RESULTED IN IN THE CONVICTION OF MONEY LAUNDERING SPECIALISTS, OFFICERS AND EMPLOYEES OF BANKS AND A BANK ITSELF FOR VIOLATIONS OF THE BANK SECRECY ACT. INDICTMENTS ARE PENDING ON A NUMBER OF OTHERS, ONE OF WHICH IS A MIAMI BANK. IN ADDITION, OUR EFFORTS HAVE RESULTED IN THE SEIZURE/FORFEITURE OF SUBSTANTIAL ASSETS, A GOOD PART OF WHICH WAS CURRENCY. SIGNIFICANT JEOPARDY/ TERMINATION TAX ASSESSMENTS HAVE ALSO BEEN MADE, RESULTING IN THE ASSESSMENT OF MORE THAN $112 MILLION IN TAXES.

SINCE "GREENBACK" WAS CREATED, IRS HAS INITIATED OVER 180 INVESTIGATIONS IN WHICH WE HAD JURISDICTION OR JOINT JURISDICATION, USUALLY WITH CUSTOMS. OF THE CASES INITIATED, PROSECUTION HAS BEEN RECOMMENDED AGAINST 120 INDIVIDUALS AND CORPORATIONS, AND AS OF JANUARY 1983, 81 OF THESE HAVE BEEN INDICTED, WITH 23 CONVICTIONS. I UNDERSTAND THAT ADDITIONAL DETAILS ON GREENBACK WILL BE PROVIDED IN OTHER TESTIMONY BEFORE THE SUBCOMMITTEE.

THE SUCCESS OF OPERATION GREENBACK HAS LED TO THE CREATION OF, AND OUR PARTICIPATION IN, MORE THAN 20 FINANCIAL INVESTIGATIVE TASK FORCES THROUGHOUT THE COUNTRY, NORMALLY LOCATED IN THE BORDER STATES. WE PARTICIPATE IN THESE TASK FORCES WITH CUSTOMS AND U.S. ATTORNEYS, AND FREQUENTLY WITH THE DRUG ENFORCEMENT ADMINISTRATION, THE FBI, AND OTHER AGENCIES AS WELL. WE FEEL THAT OUR WORK IN THESE COOPERATIVE EFFORTS, UNDER AN INVESTIGATIVE GRAND JURY PROCEDURE, HAS BEEN MOST PRODUCTIVE.

OTHER ESPECIALLY USEFUL ASPECTS OF TITLE 31 FROM WHICH WE ARE ALSO GETTING RESULTS ARE THE CRIMINAL PROVISIONS. THROUGH THEM WE NOW HAVE A MEANS TO PROSECUTE THOSE WHO ARE INVOLVED WITH AND WHO HELP OTHERS FACILITATE ILLEGAL ACTIVITIES BY ASSISTING THEM IN HANDLING THE ENORMOUS AMOUNTS OF MONEY GENERATED FROM THESE ACTIVITIES. CONVICTIONS HAVE INCLUDED OFFICIALS OF THE GARFIELD BANK, MONTEBELLO, CALIFORNIA; OFFICIALS OF THE PALM STATE BANK AND THE BANK ITSELF, TAMPA, FLORIDA; AND INDICTMENTS OF BANKS IN MIAMI, FLORIDA; ST. PAUL, MINNESOTA; AND NEWARK, NEW JERSEY.

THE SERVICE HAS RECENTY INITIATED A TASK FORCE, WITH PARTICIPATION FROM CUSTOMS, TO IDENTIFY U.S. TAXPAYERS WHO ARE USING TAX HAVEN COUNTRIES AND/OR OFFSHORE BANKS TO EVADE U.S. TAXES AND TO COMMIT OTHER RELATED VIOLATIONS (SUCH AS TITLE 31). THE TASK FORCE WILL ALSO FOCUS ON THE EXTENT OF NONCOMPLIANCE IN THIS AREA AND THE SCHEMES AND TECHNIQUES USED. THE INFORMATION DEVELOPED BY THE TASK FORCE WILL BE ANALYZED AND DISSEMINATED TO OUR FIELD OFFICES FOR INVESTIGATIVE PURPOSES.

WHILE THE AVAILABILITY OF CTR'S AND CMIR'S HAS BEEN USEFUL IN PROVIDING A LIMITED PAPER TRAIL, THE SERVICE HAS FOUND IT INCREASINGLY NECESSARY TO TURN TO THE USE OF UNDERCOVER AGENTS IN ITS INVESTIGATIONS. WE ARE FINDING THAT EVIDENCE SECURED IN THIS MANNER, WHICH WOULD NOT OTHERWISE HAVE BEEN OBTAINED USING TRADITIONAL METHODS, IS PROVING TO BE CRUCIAL IN PROSECUTING SOME CASES.

FOR EXAMPLE, IN A SEATTLE-BASED OPERATION INVOLVING AN ILLEGAL TAX SHELTER PROGRAM WHERE HUNDREDS OF INDIVIDUALS IN SEVERAL STATES WERE INVOLVED, FIVE LEADERS WERE CONVICTED OF A CONSPIRACY TO CHEAT THE GOVERNMENT OUT OF MILLIONS OF TAX DOLLARS. THEY ATTEMPTED TO DO THIS BY CREATING

FRAUDULENT DEDUCTIONS STEMMING FROM SHAM TRANSACTIONS BETWEEN INVESTORS AND FOREIGN TRUST ORGANIZATIONS SET UP IN THE BRITISH WEST INDIES AND CENTRAL AMERICA. A GOOD DEAL OF THE EVIDENCE IN THIS CASE CAME FROM TAPED CONVERSATIONS RECORDED BY UNDERCOVER AGENTS.

IN A CASE WHICH JUST BECAME PUBLIC THIS PAST WEEKEND, FIVE MEN WERE INDICTED FOR ALLEGEDLY USING A LAS VEGAS CASINO AND FOREIGN BANK ACCOUNTS TO HIDE AT LEAST $16 MILLION IN ILLICIT NARCOTICS PROFITS. THE U.S. ATTORNEY INVOLVED CALLED IT "PROBABLY THE LARGEST MONEY LAUNDERING-DRUG TRAFFICKING SCHEME IN HISTORY." ARRESTS WERE MADE IN LAS VEGAS, CHICAGO, AND BILOXI, MISSISSIPPI. SPECIAL AGENTS OF THE IRS WERE INTIMATELY INVOLVED IN THIS OPERATION FROM ITS BEGINNING, AND PLAYED A KEY ROLE IN BRINGING THE CASE TO ITS PRESENT STATUS.

THE PASSAGE OF TEFRA ALSO PROVIDED HELP TO OUR CRIMINAL INVESTIGATORS. CRIMINAL FINES RELATING TO CODE SECTIONS 7201, 7203, 7206, AND 7207 WERE INCREASED. THESE INVOLVE SITUATIONS WHERE TAXPAYERS ATTEMPT TO EVADE OR DEFEAT TAX; WHERE THEY WILLFULLY FAIL TO PAY TAX OR KEEP RECORDS OR REPORT INFORMATION; WHERE THEY TAKE FRAUDULENT ACTIONS OR MAKE FALSE STATEMENTS IN A ATTEMPT TO EVADE OR DEFEAT TAX; AND

WHERE THEY FILE RETURNS, STATEMENTS, OR DOCUMENTS KNOWN TO BE FRAUDULENT. THESE NEW FINES RANGE BETWEEN $10,000 - $100,000 FOR INDIVIDUALS AND BETWEEN $50,000 - $500,000 FOR A CORPORATION.

NEW INTERNAL REVENUE CODE SECTION 6867 PERMITS CERTAIN PRESUMPTIONS WHERE AN INDIVIDUAL IN POSSESSION OF MORE THAN $10,000 IN CASH OR ITS EQUIVALENT DENIES OWNERSHIP, AND FAILS TO IDENTIFY A PERSON WHOM CAN BE READILY ASCERTAINED AND WHO ACKNOWLEDGES OWNERSHIP. THE SERVICE MAY PRESUME THAT THE CASH REPRESENTS GROSS INCOME OF AN INDIVIDUAL FOR THE YEAR OF POSSESSION AND THAT COLLECTION IS IN JEOPARDY, AND TAKE ACTION ACCORDINGLY.

3. INTERNATIONAL

INTERNATIONAL PROBLEMS DEMAND INTERNATIONAL SOLUTIONS. RECOGNIZING THIS, WE HAVE STEPPED UP OUR LIAISON WITH OTHER CONCERNED NATIONS.

FOR A NUMBER OF YEARS, IRS HAS ACTIVELY PARTICIPATED IN SEVERAL REGIONAL INTERNATIONAL TAX ADMINISTRATION ORGANIZATIONS. THESE ORGANIZATIONS ASSIST IN MAINTAINING THE PROFESSIONAL RELATIONSHIPS, COOPERATION, AND GOODWILL SO NECESSARY FOR EFFECTIVE

TAX ADMINISTRATION ON A GLOBAL SCALE. IN ADDITION, WE ENGAGE IN FRANK DISCUSSIONS OF PROBLEM AREAS IN AN EFFORT TO IMPROVE OUR EFFECTIVENESS IN OUR RESPECTIVE COUNTRIES.

SINCE LAST JUNE, A NUMBER OF TOP SERVICE OFFICIALS HAVE PARTICIPATED IN THE 16TH ANNUAL CIAT (CENTER FOR INTER-AMERICAN TAX ADMINISTRATORS) ASSEMBLY IN ASUNCION, PARAGUAY; THE ANNUAL GROUP OF FOUR MEETING IN DIJON, FRANCE; AND THE ANNUAL PACIFIC ASSOCIATION OF TAX ADMINISTRATORS (PATA) MEETING IN SYDNEY, AUSTRALIA. WE HAVE HAD ALSO A SERIES OF BILATERAL MEETINGS WITH TAX OFFICIALS FROM CANADA, JAPAN, MEXICO, THE UNITED KINGDOM, GERMANY, AND FRANCE.

AT THE CIAT MEETING IN ASUNCION, I SPOKE ON THE SUBJECT OF "COMPLIANCE CONTROL AT THE INTERNATIONAL LEVEL", AND EMPHASIZED THE NEED FOR INTERNATIONAL COOPERATION AS A KEY TO PROGRESS ON TAX HAVENS. OTHER TOPICS AT THE ASSEMBLY INCLUDED TAX SHELTERS, TAX PROTESTERS, AND EXCHANGES OF INFORMATION.

WE ARE ALSO INVOLVED WITH THE ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, OECD, IN PARTICULAR ITS COMMITTEE ON FISCAL AFFAIRS' WORKING

Party #8, on tax evasion. OECD consists of 21 nations, primarily in Western Europe but including Japan, Australia, and Canada as well.

In all these meetings, non-compliance and information exchanges are constant topics of discussion. In fact, as a result of the Group of Four meeting, we have arranged with Germany, the United Kingdom, and France to exchange information -- under the existing treaties with those nations -- on tax haven activities. Moreover, the German Federal Ministry of Finance will host a meeting of Examiners and Inspectors in May to discuss in detail tax haven schemes and enforcement efforts, including the simultaneous examinations I mentioned earlier in my statement. We are also about to complete an agreement with Canada to engage in simultaneous investigations of suspected tax fraud. For the next PATA meeting, in September of this year, we have proposed tax havens as a U.S. topic of discussion.

To assist in providing us with better insight and information about international money laundering and economics crime, we are in the process of assigning an agent to Interpol's headquarters in St. Cloud, France for the purpose of participating in a newly created

International Economic and Financial Crime Unit. This will be in addition to the agent that we currently have assigned to the U.S. National Central Bureau of Interpol here in Washington.

Conclusion

At times, Mr. Chairman, it must seem like the "bad guys" are winning; that is, in the running battle between the promoters and users of offshore tax havens and the government, the government always loses.

Nothing could be further from the truth. I'm sure I speak for the other officials here when I tell you that we have no intention of losing this war. In fact, we are actively combatting the problems posed by offshore tax havens, and in the long run I am confident we will win. We, as a part of Treasury, are examining ways in which we can work more closely together to make more effective use of the data developed by other agencies of the Treasury and the Federal government.

One thing I'd like to emphasize is the international nature of the problem, and the corresponding need for a variety of actions to address it. Of particular value are our initiatives in the area of simultaneous examinations and the international

EXCHANGE OF INFORMATION. WORKING WITH OUR TREATY PARTNERS AND OTHER INTERESTED PARTIES, WE BELIEVE WE CAN MAKE PROGRESS IN THIS AREA. AND BELIEVE ME, WE INTEND TO TRY.

THANK YOU, THAT COMPLETES MY STATEMENT.

PREPARED STATEMENT OF HON. JOHN M. WALKER, JR.

ASSISTANT SECRETARY (ENFORCEMENT & OPERATIONS)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee;

Thank you for the opportunity to present our views on the problems raised by the use of foreign corporations and financial institutions to facilitate violations of U.S. law. Our interest in this subject flows naturally from the interests and functions of two Treasury law enforcement agencies, IRS and Customs, to protect the revenue and our national economic interests, as well as to collect taxes and duties. In addition, since the passage of the Bank Secrecy Act in 1970, we have had a special responsibility with respect to transnational investigations.

When the Bank Secrecy Act was introduced by the Chairmen of the Senate and House Banking Committees, it was clear that they intended the Bank Secrecy Act to play a major role in combatting the use of foreign bank accounts to facilitate violations of U.S. laws. During the hearings that preceded the passage of the Bank Secrecy Act, officials from several government agencies testified concerning the need for assistance in identifying suspicious transactions and movements of currency and documenting international transactions in general. The Act was intended to assist law enforcement officials by providing for the retention of records of all significant international transactions as well as reports of unusual domestic currency transactions, the international transportation of currency and other monetary instruments, and reports of international financial transactions or accounts. It is the linchpin for all investigations of financial activity; it was specifically designed to deter transnational crimes.

The reporting requirements of the Bank Secrecy Act provide a unique way to follow unusual cash flows including cash flows caused by major drug traffickers and their money launderers. Indeed, the tracking of cash flows through the reporting requirements of the Act frequently leads to the identification of drug trafficking organizations. As an added bonus, the Bank Secrecy Act imposes criminal sanctions on those who fail to comply with its requirements. The major narcotics trafficker, who carefully insulates himself from actually handling drugs, can still be brought before the bar of justice for failure to comply with the reporting requirements of the Bank Secrecy Act or for income tax violations, even though there may be an inability to establish the underlying narcotics offense.

The Act authorizes the Secretary of the Treasury to issue regulations to carry out the purposes of the Act. The principal provisions are:

1. Banks and other financial institutions must maintain records that the Secretary determines have a high degree of usefulness in criminal, tax, or regulatory investigations.

2. They must report to the Treasury Department transactions involving currency or other monetary instruments as the Secretary may require.

3. The international transportation of currency and other monetary instruments in excess of $5,000 must be reported to the Treasury Department.

4. The Secretary must require U.S. citizens, residents, and persons doing business in the United States to maintain records or file reports, or both, of foreign financial transactions.

Regulations

After considering the Congressional mandate expressed in the Act and the committee reports, the Treasury Department issued regulations which currently contain the following recordkeeping requirements:

1. All financial institutions are required to maintain the following records:
    a. Instructions, given or received, concerning the transmission out of the U.S. of credit funds, currency or other monetary instruments, checks or securities of more than $10,000.
    b. Each extension of credit in excess of $5,000 except for those secured by real estate.
2. Banks, savings and loans, and credit unions must also retain a copy of the following records:
    a. Documents granting signature authority over each deposit or share account.
    b. Statements of accounts.
    c. Checks and other charges in excess of $100 that are posted to accounts. (Checks drawn on certain volume accounts are exempted.)
    d. Each check or other item in excess of $10,000 transmitted outside the U.S.
    e. Each check or draft in excess of $10,000 drawn on or issued by a foreign bank which is paid by the domestic bank.
    f. Each check in excess of $10,000 received directly from a foreign financial institution.
    g. Records of each receipt of currency, other monetary instrument, securities, checks or credit received from a foreign financial institution.

h. Records necessary to reconstruct a checking account and to furnish an audit trail for each account transaction over $100.

3. Securities brokers under the supervision of the SEC have been subject to recordkeeping regulations for many years. The Treasury regulations, however, added the requirement that brokers obtain a signature card or similar document establishing trading authority over an account and make a reasonable effort to obtain a Social Security number of each account.

In addition, the regulations prescribed the following reporting requirements:

1. Financial institutions are required to report to the IRS domestic currency transactions in excess of $10,000 (IRS Form 4789). Transactions with retail type businesses and other domestic banks are exempted.

2. Except for certain shipments made by banks, the international transportation of currency and certain other monetary instruments in excess of $5,000 are required to be reported to the Customs Service (Customs Form 4790).

3. U.S. persons are required to report annually a financial interest in or signature authority over a foreign financial account. Certain records of such an account are required to be maintained in the U.S.

Compliance Responsibilities

Sections 128 and 205 of the Act, which gave the Secretary the responsibility for assuring compliance, also gave him authority to delegate such responsibility to the appropriate bank supervisory agency or other supervisory agency.

In accordance with that authority, the responsibility for assuring compliance with the requirements of the regulations has been delegated as follows:

1. To the Comptroller of the Currency, with respect to national banks and banks in the District of Columbia;

2. To the Board of Governors of the Federal Reserve System, with respect to State bank members of the Federal Reserve System;

3. To the Federal Home Loan Bank Board, with respect to insured building and loan associations, and insured institutions as defined in section 401 of the National Housing Act;

4. To the Administrator of the National Credit Union Administration, with respect to Federal credit unions;

5. To the Federal Deposit Insurance Corporation, with respect to all other banks except agents of foreign banks which agents are not supervised by State or Federal bank supervisory authorities;

6. To the Securities and Exchange Commission, with respect to brokers and dealers in securities;

7. To the Commissioner of Customs with respect to reports of transportation of currency or monetary instruments and forfeiture of currency or monetary instruments;

8. To the Commissioner of Internal Revenue except as otherwise specified. This means, in effect, that the IRS has the responsibility for enforcement of those sections requiring persons who have foreign bank accounts to report them and to keep records pertaining to them, and those sections requiring financial institutions to report large and unusual currency transactions, as well as a responsibility to make certain that dealers in foreign exchange, transmitters of funds, unsupervised or secret agents of foreign banks, and similar financial institutions are complying with the recordkeeping provisions of the regulations.

. Overall responsibility for coordinating the procedures and efforts of the agencies listed above and for assuring compliance with the regulations has been delegated to my office.

The regulations were designed to provide an integrated system for tracing and documenting the overwhelming majority of financial transactions that might be of interest to investigators. Financial institutions are required to maintain records of checks, wire transfers, and other movements of funds and be able to reconstruct transactions accounts. The currency transaction reports and reports of the international movement of monetary instruments are intended to fill the gaps in the system resulting from the use of currency and bearer instruments. In addition, the reports are also intended to alert the law enforcement community to specific activity that appears to warrant investigation.

We recognize that we are very dependent on the Federal bank supervisory agencies. Their bank examiners have the primary responsibility for the enforcement of the regulations. The examiners must see that the records are retained and the unusual currency transactions are properly reported. In recent years, they have made a major commitment to the enforcement of the Bank Secrecy Act. In 1981, they began using expanded examination procedures which require them to review retained copies of currency transaction reports and to ascertain that a financial institution has a program of employee education, written operating procedures, and an adequate internal compliance program.

FLEC

In 1982, the Financial Law Enforcement Center (FLEC) was established within Customs. The Center has assumed the responsibility for collecting, collating, and analyzing the report data obtained from the three reports required to be filed with the Treasury Department under the provisions of the Bank Secrecy Act. These functions were performed previously by the Reports Analysis Unit which was superseded by FLEC. FLEC assists law enforcement agencies in developing strategies that will exploit the vulnerability of the financial aspects of criminal activity. FLEC combines the talents of criminal investigators intelligence research analysts, and ADP specialists into one integrated organization. At the present time, both Customs and IRS have assigned employees to FLEC.

Administrative Actions

In 1980, we realized from our review of compliance in Florida that the regulations pertaining to the currency transaction reports needed to be tightened up. Some banks had been exempting individuals with Latin American addresses from the currency transaction reporting requirements because these persons brought large amounts of currency into the bank on a regular basis. Unfortunately, too often these customers also happened to be suspected drug traffickers. In addition, some banks frequently accepted shopping bags or boxes of currency from couriers whose identity they did not bother to verify.

The regulations were amended in 1980 to limit a bank's authority to exempt currency transactions from the reporting requirements. Only deposits and withdrawals by an established depositor, who is a U.S. resident and operates a retail business in the U.S. can be exempted without the approval of the Treasury Department. More specific identification requirements were also provided. Financial institutions are now required to verify the identity of persons who conduct reportable currency transactions with them. The identity of aliens and persons who are not U.S. residents must be made by passport, or some other official document. While these changes have created an additional burden for banks, there is no doubt in my mind that they were justified.

We have taken several other actions to improve filing compliance and the quality of the currency transaction report data base:

1. The IRS corresponds on reports which do not meet the minimum criteria for processing and, if they are unable to resolve the problem through correspondence, the report is referred to the responsible supervisory agency.

2. The IRS is revising Publication 1148 in order to provide more detailed instructions for the preparation of the currency transaction report.

3. Guidelines for the compliance agencies to use in recommending civil penalties for violations of the regulations are now in the final review process.

4. The Florida State Banking Division has been very active in checking state chartered banks for compliance with the reporting provisions. We have been assisting them in that effort and have been exploring other ways in which they could help with the money laundering problem in Florida.

5. We have been developing summary reports of the report data for use by the bank supervisory agencies in checking compliance with the currency transaction reporting requirements and in identifying areas of the nation where compliance appears to be low.

Obviously, as the quality of the data base improves, the the more useful it will become, not only for individual investigations but for analytical reports. For example, we have found that analysis of the volume of currency transactions between U.S. banks and foreign persons or institutions is very valuable in indicating areas where additional investigative action should be taken.

Operation Greenback

In 1980, Treasury's Office of Enforcement and Operations, with the cooperation of the IRS, Customs, and the Department of Justice, developed Operation Greenback. It is an integrated investigation of the huge surplus of currency in the Federal Reserve banks in Florida which we believe results, in part, from illegal activity. The surplus grew from $1.5 billion in 1976 to a peak of $5.8 billion in 1980. In 1982 it declined to $5.3 billion. Operation Greenback was based primarily on two concepts. First, an attack on the illegal activity associated with the currency could be made through the financial operations of the violators. The tax laws and the reporting and recordkeeping requirements of the Bank Secrecy Act, could be effectively employed in this effort. Second, the criminal investigations should be integrated through the use of the grand jury process with Federal prosecutors coordinating all of the related investigations. Since the inquiry is being conducted under the authority of a grand jury, all of the Federal agents participating in it can pool information, including tax or other financial information. This kind of sharing which streamlines the investigative process, is not permitted under the procedures governing administrative inquiries.

The Operation Greenback strategy also included certain administrative actions. Through the analysis of Federal Reserve bank records, currency transaction reports, and related information, Treasury identified 24 banks that had handled unusually large amounts of currency. Those banks were given special indepth examinations by the Federal banking authorities. The examinations identified several institutions where investigations of possible criminal violations were initiated. The IRS was also encouraged to undertake civil tax examinations of those persons involved in unusual, large currency transactions.

Operation Greenback has documented $2,065,000,000 in U.S. currency that has been laundered through international transactions by seven different organizations. The amounts for each are listed below. The schedule does not necessarily include all of the currency laundered by each organization, nor the entire length of time it was in operation.

Case Designation	U.S. Currency Laundered	Time Frame
A	$ 300,000,000	2 Years
B	500,000,000	3 Years
C	268,000,000	5 Months
D	250,000,000	20 Months
E	130,000,000	3 Years
F	300,000,000	3 Years
G	70,000,000	8 Months
H	17,000,000	8 Months
I	230,000,000	3 Years
Total	$2,065,000,000	

The above figures are from cases either under investigation, indicted or prosecuted.

During the 30 months of operation, ending December 31, 1982, Treasury has seized more than $28 million in currency. In addition, property in excess of $2.5 million has been seized. Appearance bonds in excess of $1.8 million have been forfeited and jeopardy tax assessments totalling more than $112 million have been made. There are approximately 40 special agents from IRS and Customs assigned to Operation Greenback.

The combined effort of the IRS and U.S. Customs Service has resulted in approximately 140 indictments, 44 convictions, and approximately 90 cases are pending trial.

Other Significant Cases

Although Operation Greenback cases tend to overshadow the other cases, a large number of significant Bank Secrecy Act investigations are underway in many cities across the country. (More than 20 financial investigative task forces have been established throughout the United States and Puerto Rico.) Several of the investigations involve international transactions or foreign financial institutions. For example, a Federal strike force investigation initiated by Customs in Detroit resulted in the conviction, in 1981, of a group of individuals who were charged with a criminal conspiracy to launder money in order to convert corporate assets to their own use, bribe employees of commercial customers, and evade taxes. The scheme involved the transportation of monetary instruments to Canada, where they were converted to cashiers checks. Civil penalties under the Bank Secrecy Act of about $1,000,000 were also assessed in this case.

In another case in October, 1981, a bank in California and its chairman pled guilty to Bank Secrecy Act charges that involved drugs, tax evasion, and international financial transactions. The bank official and other defendants were charged with conspiring with an attorney to provide money laundering services for narcotics traffickers who had large quantities of currency that were derived from their illegal activities. The currency was accepted by the bank and the funds were wired to trusts at the Bank of Bermuda. The funds were then wired back to the United States for the traffickers. The attorney prepared fictitious documents to make it appear that the money from the trusts had a legitimate non-taxable source.

Need to Amend the Bank Secrecy Act and Regulations

Mr. Chairman, as I have recited in this statement, a massive effort has been made to ensure that the records needed to trace financial transactions through banks in this country are available for law enforcement purposes. To the best of my knowledge, that effort has been very successful. Transactions that occur in this country can be documented. In addition, Customs, IRS and other Federal supervisory agencies are expending a great amount of time in obtaining compliance with the reporting requirements and in analyzing the report data. However, in spite of our successes there is abundant evidence that much more needs to be done. Information available to us indicates that millions of dollars in cash is being transported out of the country without filing the required currency and monetary investments report. Foreign banks and corporations continue to be used to thwart our efforts to enforce the law. In my opinion, much of the weakness in the system could be overcome by making the following changes in the Bank Secrecy Act:

1. Amend Section 5316 of Title 31 by making it a crime to "attempt to transport or cause to be transported" monetary instruments in excess of $10,000 without filing a report with Treasury (Customs).

2. Amend Section 5317 of Title 31 by authorizing Customs officers to stop and search a vehicle, vessel, aircraft or other conveyance, envelope or other container, or person entering or departing the United States if there is reasonable cause to believe there is a violation of the reporting requirements.

3. Add a new section authorizing the Secretary of the Treasury to pay rewards, except to certain Federal, State and local officers, for original information leading to the recovery of a fine, penalty, or forfeiture exceeding $50,000. It should provide that the Secretary shall determine the amount of the reward but in no case shall it exceed 25 percent of the net amount of the fine, penalty, or forfeiture assessed. There should also be a provision for necessary appropriations.

However, I believe that the information that we have received from the investigative efforts in Florida and the analysis of financial data indicates that we also need to take action to strengthen our Treasury regulations. We are going to draft amendments to the Bank Secrecy Act regulations that would require currency exchanges and the dealers in foreign exchange to maintain adequate records of their transactions. These institutions have played a major role in laundering money in Florida and other states. They function like a bank in many respects and should be subject to the same type of recordkeeping provision as banks.

In addition, it appears that the time has come to more fully utilize the Treasury Department's authority to require reports of foreign financial transactions. There have been many statements regarding the need for law enforcement agencies to be alerted to unusual international movement of funds by cashiers check, wire transfer, or other methods. Although the Bank Secrecy Act (31 U.S.C. 5314) would authorize a requirement that such transactions be reported to the Treasury Department, we have been reluctant to exercise it. There are too many international transactions that are related to legitimate commerce to warrant a shotgun solution to the problem. Nevertheless, it is increasingly clear that law enforcement officials need assistance in identifying those persons who are using foreign financial facilities to further their criminal activities. In my opinion, a reasonable approach to the problem would be for the Treasury Department, on the basis of information indicating that there has been a probable misuse of foreign financial facilities by U.S. persons, to impose selective reporting. For example, if there is reason to believe that banks in a foreign country are being utilized to further illegal activity, the Secretary could require specific classes of persons or domestic financial institutions to report their transactions with these foreign banks. We believe that such a requirement would be extremely useful to the IRS in tax enforcement, as well as to other Federal agencies interested in transnational crime.

Banks located in offshore tax havens are ideally suited to the purposes of the narcotics trafficker. We have seen in Operation Greenback a number of situations where U.S. currency has been laundered through international transactions. The trafficker's goal, once he has sold his product, is to hide his money or to cleanse his money so that he can put it to use without it being attributed to him as unreported income. A tax haven with bank secrecy facilitates achievement of this goal by providing a veil of secrecy over parts of the transaction, so that the taxpayer cannot be definitely tied to the flow of funds. Furthermore, the tax haven's infrastructure, which often includes modern banking and communications facilities, serves to facilitate rapid movement of funds.

The problem can be illustrated by a simple case. A narcotics trafficker arranges for a courier to carry $200,000 in cash in a suitcase to the Cayman Islands where it is deposited in a small so-called "offshore bank". The courier does not file a Form 4790. The money goes into an account of a Bahamian registered company which is purchased for a small sum. Business transactions are then run through this company. The company then transfers $100,000 to an account in its name at the branch of a large money center bank. The narcotics trafficker then borrows $100,000 from the Bahamian company. Both the trafficker and the corporation claim that the loan is simply a signature loan to an individual. In fact, the loan is effectively secured by the Cayman deposit.

Similarly, the drug trafficker can get funds to an offshore bank by having a courier open an account in a Miami bank in a fictitious name and deposit large sums of cash in a short period of time. The money in the deposit can then be wired to an offshore bank and handled in the same manner as outlined above. The courier presumably "beats the system" by using a fictitious identification in an effort to avoid detection.

Amendments to the Bank Secrecy Act which would give the Customs Service an attempt provision and an outbound search authority would help in our efforts to get the courier who transports large sums of cash to offshore banking havens without filing the requisite form. The existing provisions of the Bank Secrecy Act help us to identify and prosecute the courier who makes large cash deposits in a domestic bank. The regulatory changes which we are considering would require specific domestic financial institutions to report their transactions with banks in certain foreign countries. This would assist us in overcoming the advantages of using offshore banking havens to shield questionable transactions from government scrutiny.

Mr. Chairman, I would appreciate it if the Subcommittee would consider and support these proposals. I believe that they would be major contributions to our efforts to overcome the use of foreign banks to conceal illegal activity.

PREPARED STATEMENT OF ALAN W. GRANWELL

INTERNATIONAL TAX COUNSEL

U.S. DEPARTMENT OF THE TREASURY

BEFORE THE PERMANENT SUBCOMMITTEE
ON INVESTIGATIONS OF THE SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to provide an overview of some of the initiatives of our tax treaty program to prevent the avoidance and evasion of U.S. income taxes.

The Purpose of Tax Treaties

As background to my discussion, it may be useful to briefly review with you the purposes of income tax treaties. The two primary purposes of bilateral income tax treaties are to mitigate double taxation of income and to provide mutual assistance in combatting tax avoidance and evasion.

With respect to the mitigation of double taxation, income tax treaties divide the taxing jurisdiction between the two countries that are parties to the tax treaty. In general, with respect to particular item of income, the country in which the income arises (the source country) is required by the treaty, to reduce or eliminate its tax in favor of tax by the country of residence of the recipient.

In return, the country of which the taxpayer is a resident is obligated to relieve double taxation, to the extent that a tax is imposed in the source country, by allowing a credit for the source country tax or exempting the income from its tax, as the case may be.

In the normal treaty relationship there are flows of income in both directions; therefore each country will cede all or a portion of its right to tax certain income from sources in its country and each country will provide relief with respect to income of its residents from sources in the other country. In that regard, income tax treaties generally provide for reduced rates of tax at source on investment income (dividends, interest and royalties) by the host country so that the aggregate tax burden on the investor will not exceed that which he would pay if he invested at home.

With respect to exchange of information, tax treaties provide elaborate mechanisms for each contracting state to, among other things, obtain tax-related information with respect to their residents and other taxpayers and consult with the tax authorities of the other state on measures to prevent the avoidance and evasion of taxes.

Treaty Shopping

One treaty abuse that the United States is trying to control is treaty shopping. Treaty shopping, in essence, is the ability of residents of countries other than the countries that are parties to the treaty to derive treaty benefits, such as rate reductions on passive income, by channelling investments through entities organized in, or resident in, a treaty jurisdiction. Treaty shopping results in tax avoidance because treaty benefits are obtained by unintended beneficiaries. This weakens our ability to expand our treaty network and to successfully renegotiate more favorable provisions in our existing treaties. Thus, if residents of countries with which the United States has no treaty can avail themselves of U.S. treaty benefits, their countries of residence may have little incentive to enter into treaties with the United States. Similarly, if residents of countries which have a tax treaty with the United States can obtain greater benefits by treaty shopping, in cases where U.S. residents cannot obtain reciprocal benefits, their countries of residence are under little or no pressure to renegotiate their treaties to address U.S. concerns.

It is established U.S. tax treaty policy to include a limitation of benefits article to prevent treaty shopping. These provisions act to, among other things, deny treaty benefits in appropriate circumstances and thereby permit the United States to impose its full statutory rate of tax on payments to such interposed entities. Limitation of benefits provisions will be employed wherever necessary, and in the form appropriate to the circumstances, to assure that U.S. policy goals are served by the extension of benefits in our tax treaties.

Re-examination of Tax Treaty Compliance

Under present law, a recipient of U.S. source dividends who has an address in a country with which the United States has a tax treaty which provides for a rate reduction with respect to such income will, with limited exceptions, be presumed to be a resident of such country for purpose of obtaining reduced rates of tax on such dividends. With respect to interest and other types of passive income, a foreign taxpayer may obtain a rate reduction by certifying his eligibility for treaty benefits to the withholding agent.

Both of these methods of obtaining reduced rates of tax under a treaty are subject to abuse. The address system of withholding of tax on U.S. source dividends is particularly vulnerable since such system permits tax evasion by persons who are not legitimate treaty beneficiaries but who merely establish post office boxes or nominee accounts in countries with which we have a tax treaty providing for reduced rates of tax on dividends. The only real check on this abuse is provided by certain of our treaty partners who collect and remit additional taxes to the United States if they determine that a particular dividend recipient is not a bona fide treaty beneficiary. However, much abuse goes undiscovered and, even with respect to amounts remitted by our treaty partners, substantial costs in terms of delay and uncollected interest are inevitably incurred. The self-certification procedure which applies to interest and other types of passive income is similarly subject to abuse in that it requires a person claiming treaty benefits merely to submit an unverified, self-serving statement to a withholding agent, who is entitled to rely on such statement for purposes of reducing the amount of tax withheld. The Treasury Department detailed its concerns with respect to these procedures in testimony at hearings held on June 10, 1982 before the Subcommittee on Commerce, Consumer, and Monetary Affairs of the House Government Operations Committee (the "1982 Hearings").

Section 342 of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") was enacted in response to the the concerns raised at the 1982 Hearings. Section 342 directs that procedures be designed which will prevent the kind of abuse that occurs through the improper use of nominees and other conduits that pass U.S. source income through to a person who is not a bona fide resident of the treaty country.

A number of alternatives to the present enforcement system exist, including the adoption of a refund system of withholding tax on passive income. A refund system would require withholding agents to withhold U.S. tax at the statutory 30-percent rate on all U.S. source passive income paid to foreign persons, regardless of the potential application of a treaty provision reducing the 30-percent rate or eliminating the tax altogether. The foreign recipient who claims treaty benefits would then be required to file a claim for a refund on an annual tax return. Supportive documentation would be required. Another approach, the "certification system," would require the foreign recipient to file a certificate of residence from the competent authority of the country whose treaty benefits are being sought. Pursuant to the mandate of section 342, we are presently considering such stricter procedures.

Exchange of Information

It is an established principle of international law that a country is not obliged to assist in the enforcement of the penal or tax laws of another country in the absence of an applicable treaty or bilateral agreement. Different types of international agreements may be used by the United States as a basis for obtaining information about foreign activities of U.S. taxpayers, including bilateral income tax treaties, bilateral mutual assistance treaties, and exchange of information agreements.

Exchange of Information Under Income Tax Treaties

Tax Treaty Provisions. Each of our income tax treaties contains a provision requiring the exchange of tax information. The scope of these provisions varies considerably.

Our 1981 draft model income tax treaty ("1981 Model"), which serves as our opening position in treaty negotiations, contains very broad information exchange provisions. It extends to any information necessary for carrying out the provisions of the treaty or the domestic laws of the contracting states concerning taxes covered by the treaty insofar as the taxation thereunder is not contrary to the treaty. The 1981 Model also provides that, for purposes of information exchange, the taxes covered by the treaty are deemed to be all taxes imposed by a contracting state at a national level, thereby including taxes other than income taxes covered by the treaty. The broader information exchange provisions of the 1981 Model have been included in our recently ratified treaties.

Because exchange of information provisions cannot be totally expansive, the 1981 Model include certain limitations on the obligations of the parties to gather or exchange information. There is a provision expressly limiting obtainable information to that available under the laws of the requested state. In addition, a requested state is typically not required (1) to carry out administrative measures at variance with its laws and administrative practice or those of the requesting state, (2) to supply information not obtainable under the laws or in the normal course of the administration of either state; or (3) to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or any information the disclosure of which would be contrary to public policy.

The information exchange provisions in the 1981 Model also contain limitations on the use of information exchanged. Information exchanged must be subject to the same taxpayer protections of secrecy as tax information normally receives in the requesting state. The information may in any event only be disclosed to persons involved in the assessment, collection or administration of the tax laws of the other country. In that regard, the Treasury has made special efforts to ensure access by the General Accounting Office to information received under tax treaties. The 1981 Model also provides that information may be disclosed in public court proceedings or decisions.

Kinds of Information Exchange Employed by the United States Under Tax Treaties. The United States generally engages in three methods of information exchange under current tax treaty provisions:

(i) routine or automatic exchanges, consisting primarily of the exchange of names of taxpayers and the amounts of passive income they receive from sources within the other contracting state;

(ii) exchanges of information on the specific request of one of the contracting states;

(iii) spontaneous exchanges of information, transmitted at the discretion of the transmitting country, when information comes to its attention which suggests or establishes noncompliance with the tax law of the other contracting state.

In addition, the Internal Revenue Service has executed simultaneous examination agreements with five treaty partners. These agreements provide for simultaneous examination of multinational corporations in carefully selected cases. Generally, these examinations are of multinational corporations engaged in tax haven operations. The program has been successful and the Internal Revenue

Service is in the process of extending it to other treaty partners.

The Internal Revenue Service has also undertaken industrywide exchanges of information with treaty partners. The objective of these exchanges is to secure comprehensive data on worldwide industry practices in such industries as oil and gas and pharmaceuticals.

The United States is continually striving to develop new and improved methods to cooperate in information exchange with our tax treaty partners to combat international tax avoidance and evasion.

Mutual Assistance Treaties

The United States is also engaged in negotiating mutual assistance treaties in criminal matters. I will leave discussion of these treaties to my colleagues from the Justice Department.

Exchange of Information Agreements and the Caribbean Basin Initiative

There are countries which do not have an income tax treaty with the United States, either because agreement on terms is not possible or because they do not have income taxes, but with whom it may be possible, in certain circumstances, to negotiate a more limited agreement to exchange information. This approach has been proposed in the Caribbean Basin Initiative ("CBI") legislation, which requires an exchange of information agreement as a condition precedent for the extension of certain U.S. tax benefits relating to tax deductions for foreign conventions held in a qualifying CBI country.

More specifically, the CBI legislation authorizes the Secretary of the Treasury to negotiate and conclude the exchange of information agreements. While the Secretary is accorded discretion regarding the kinds of information to be included within the scope of the exchange of information provisions, the legislation imposes certain minimum standards for such agreements. The exchange of information provisions in the agreements must include within their scope tax information (both civil and criminal) pertaining to U.S. taxpayers, residents of the CBI country and "third-country persons," that is, nationals or residents of countries other than the United States or the CBI country that is a party to the agreement. This approach is consistent with our present tax treaty policy, embodied in our 1981 Model. Thus, a jurisdiction with restrictions on disclosure of information regarding such third country persons or having financial secrecy laws would have to modify such laws to enter into such agreements and obtain the tax benefits of the CBI.

Conclusion

The approaches I have described are an important part of the initiatives undertaken by the United States to combat international tax avoidance and evasion.

I thank you Mr. Chairman and members of the Subcommittee for your interest in the matters which we have addressed today and am pleased to have had the opportunity to consider these important issues with you.

PREPARED STATEMENT OF BENO GHITIS-MILLER

CRIME AND SECRECY: THE USE OF OFFSHORE BANKS AND COMPANIES

My name is Beno Ghitis. I am a Colombian citizen currently serving six years in federal prison for violation of U.S. currency reporting laws.

My family in Colombia has been in the currency exchange business for over twenty-five years. I took over that business from my father in 1978. Prior to that I had been manufacturing hi-fi systems in Colombia. I have a Bachelor's Degree in Chemical Engineering, a Master's degree in Computer Science, and had done partial work on a Doctorate.

Generally, the currency exchange business involved buying dollars from Colombians in the U.S and Colombia and paying in Colombian pesos.

Our exchange house in Colombia was known as Viajes Altas. We were licensed to buy U.S. dollars in Colombia and were one of the largest exchange houses. In 1978, when I took over my father's business, there were approximately 20 exchange houses in Colombia exchanging in excess of $500,000 a month. But by the beginning of 1980, my business was averaging around $50,000,000 a month. In fact, we had grown so large that most of the banks in Colombia were buying their dollars from us.

There are many reasons for the growth of the money exchange business in Colombia. Probably fewer than 10% of the Colombian population uses bank accounts, either because they are illiterate or they don't trust banks. The Colombian government itself estimates that up to 50% of the Colombian economy is underground. Additionally, the Colombian government discounts dollars from between 6% to 11%. Given this, and the tremendous amount of U.S. dollars in Colombia, conditions were perfect for my business.

My exchange house paid more for the dollar than the leading banks and guaranteed anonymity and thus was able to thrive. For instance, in 1979, the official rate was 45 pesos per dollar. The Banco de Republica was paying only 42 pesos per dollar. I, on the other hand, was paying 43 and selling at 44. Thus the rate offered by my exchange was in between the bank rate and the official rate and we could flourish. In an attempt to benefit also from this trend, Colombia began buying dollars through what became known as the "sinister window". This window allowed a Colombian to sell his dollars without presenting any identification. This did not affect our business significantly because of our rates, and due to the fact that the bank purchased dollars only if physically located in Colombia.

A very common occurance is for Colombians in the United States to send money home to their families. This money almost always is in the form of currency. Approximately 30% of my exchange business was of this type. These transactions would begin by a Colombian citizen coming to our office in Miami for assistance in converting dollars to pesos. We would accept his deposit of dollars and, once the transaction had cleared our bank, we would issue pesos to the Colombian.

I purchase checks, in dollars in Colombia. However, I began having so much trouble with bad checks and people complaining about transit time, that it became much more feasible to have currency delivered to my office in Miami.

The majority of my business came from individuals and companies involved in the black market. As an example, if a shrimper fished within the coastal waters of Colombia and sold his catch through legitimate channels, he would not only have to pay a heavy export duty, but would be subject to income taxes as well. Moreover, there are not large processing facilities for shellfish in Colombia. As cheating the government is a favorite past-time in Colombia, the fisherman instead goes outside the coastal waters and transfers his catch to a U.S. shrimper. The Colombian shrimper now has the problem of getting paid. He can't use Colombian banks because the currency exchange would identify the black market transaction. He therefore comes to us. We would tell him to have the U.S. dollars paid by the shrimper, deliver in currency to Sonal in Miami. As soon as we are notified of the receipt, we issue pesos to the Colombian shrimper.

The other side of this transaction consists of selling dollars in Colombia. Colombian businesses need dollars to purchase virtually anything outside the country. For example, Mercedes Benz accepts dollars but will not accept pesos. Thus the Mercedes dealer must pay for his imports in dollars. However, his sales are in pesos and he cannot buy dollars in Colombia from the government without a license. Therefore, he comes to us.

Prior to 1981, I operated strictly out of my Colombian office. In 1981, my business had grown to such a degree that I hired an agent in the United States to receive and package my currency deposits. This office became what was labeled by the Government as my "Sonal office" in Miami, which was housed four floors above our bank. By 1981, Sonal's business had changed in that only 10% of the dollars were received in Colombia and 90% was purchased from large clients and delivered in Miami. In fact, the largest portion of the currency purchased came from two Colombian exchange houses having agencies in Miami.

The operation of one of them had grown along with Sonal's over the years. Although it also ran a currency exchange, it did not have the history or reputation of the Ghitis family. It was, however, at the top of a large nationwide pyramid of money exchangers operated in the Colombian communities throughout the United States.

Sonal's business grew dramatically in late 1980 and in the last eight months of operation, prior to being closed by the government we had exchanged one-quarter of a billion dollars in currency from our Miami office. The federal government investigation has effectively terminated my business.

This completes my testimony.

PREPARED STAFF STATEMENT
OF THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

March 15, 1983

A part of the Subcommittee's inquiry into offshore banking focused on the Oxford International Bank & Trust Co., Ltd., in the Turks & Caicos Islands, British West Indies. The striking conclusion derived from this phase of the investigation is that offshore banking accounts are being used by people one might regard as "average American citizens." Our examination of records from this bank found that just 11 American account holders deposited more than $1 million in a little more than a year.

One wonders if this small number of depositors of one small bank on an obscure island in the British West Indies might not be indicative of the enormity of the offshore banking industry and the extent to which U.S. citizens have become involved.

Our investigation also revealed a connection between offshore banks and the so-called "tax protest movement" in the United States. Offshore banks and trusts have provided an ideal vehicle for the tax protester to avoid or evade U.S. taxation. While a key element in this subterfuge is secrecy, the Subcommittee staff was able to pierce the secrecy surrounding Oxford Bank account holders. The following discussion details our efforts to pursue leads and obtain the cooperation of account holders in our attempts to discover why Americans resort to offshore banking.

The Oxford Bank in the Turks and Caicos came to the Subcommittee's attention in 1981 during an investigation of international narcotics trafficking. On February 3, 1982, the Subcommittee issued a subpoena to the Southeast Bank, N.A., of Miami, Florida, as U.S. correspondent bank for Oxford. The Subcommittee received a limited sampling of photocopies of cancelled checks, bank statements, items deposited and records of wire transfers of funds for the period of January 1, 1975 through December 31, 1981.

In June 1982, the Subcommittee staff interviewed Thomas Stocks, who was president of Oxford Bank from its inception in 1975 until his resignation in 1979. His banking career spans 25 years and includes management positions with several large Midwestern banks. According to Stocks, the Oxford Bank was founded and owned by Norman Michael of Boynton Beach, Florida. It was a full service bank with offices in Grand Turks, North Caicos and Provodencialas. The only other full service bank on the islands at the time was Barclays Bank of London.

Stocks described the Turks & Caicos Islands as a British colony with no taxes and virtually no laws or regulations concerning onshore or offshore banking. He said the independence of the Bahamas had created a huge new market for Caribbean banking and literally billions left the Bahamas for places like the Cayman Islands. Stocks said this outflow of funds was due in part to European and South American distrust of the newly independent Bahamian government in 1973.

In 1975, when Michael approached Stocks about becoming president of Oxford Bank, Stocks said, Michael told him that by the end of the first year of operation he expected to provide at least $3 million in capitalization. The bank was initially capitalized with $250,000. Michael never provided the additional capital, Stocks said, and it therefore was always undercapitalized. This is said to have contributed to its eventual demise.

Two incidents involving the Oxford Bank typefy the questionable dealings in which the offshores became involved. These incidents are detailed in Mr. Stock's testimony.

The Oxford Bank was closed in 1979 for 21 months and reopened as the Provident International Bank, Ltd. In January 1983, the Subcommittee learned that Provident was temporarily closed, for unknown reasons, but was once again planning to reopen.

The Subcommittee's review of records obtained from Oxford's correspondent bank, Southeast Bank, revealed a fascinating pattern of account activity for certain U.S. citizens. Essentially these account holders--individuals and businesses--were depositing what appear to be gross income items or gross receipts into their accounts at the Oxford Bank. These same account holders were receiving large lump-sum checks from Oxford Bank.

A common money laundering scheme used by criminals in the U.S. involves the transfer of money to an offshore account and the return or repatriation of these monies back to the account holder from the offshore bank in the disguised form of a loan from an offshore company. Quite often, therefore, what appears to be a legitimate loan from the offshore bank is, in reality, the repatriation of the criminal's ill-gotten gains.

A similar pattern found among certain Oxford Bank accounts prompted us to question Stocks. He said many of the accounts in question had been opened by or upon the advice of one Lowell Anderson. Stocks said Anderson visited the Oxford Bank several times a year, often bringing in individuals to open accounts.

The Subcommittee has learned that Lowell Anderson has recently been indicted by a federal grand jury on multiple tax law violations. This indictment resulted from his involvement in the sale of offshore trusts to U.S. citizens. Anderson has admitted to being a member of the Patriots and the Pose Comitatus, two highly visable tax protest groups in the United States. Investigation revealed that many of the customers he referred to the Oxford Bank may also be associated with the tax protest movement in the United States.

The Subcommittee staff added several account holders to those identified by Stocks and began to compile a list of U.S. individuals and businesses whose account activity at the Oxford Bank warranted further inquiry. Additionally, the staff subpoenaed the records of two other offshore banks which also maintained correspondent relationships with the Southeast Bank in Miami. We obtained records of the Barclays Bank International, Limited, and the Cayman National Bank and Trust Company, Limited, both Cayman Island banks. To avoid tourist account activity we specifically requested records of account activity during the summer months of 1981. From these records we identified for example, a Wheaton, Illinois company which fit the pattern identified in the Oxford Bank accounts.

The staff sought to locate and interview these account holders to determine their reasons for maintaining an offshore bank account and to solicit their cooperation in our investigation. The investigation was seen as a means of enhancing our understanding of the uses of offshore banks by U.S. citizens.

The Subcommittee staff identified and contacted the owner of the Wheaton company. He referred us to his attorney. We contacted the attorney who stated he would discuss with his client our request for information regarding the offshore bank account. As yet we have not received an answer to our request.

Investigation of the Oxford Bank account holders eliminated several who actually had Turks and Caicos businesses or residences and thus an obvious reason for having an account. The inquiry began to focus on those individuals and entities whose only offshore nexus seemed to be an Oxford account.

The following list represents the individuals and businesses which were the subject of this phase of our investigation:

Dr. W.E. Sedivy
Fremont, Nebraska
dba/Agri Nutrition Products, Co.

Ray & Vera Michel
Portland, Oregon
dba/R.S. & Vera D. Michel Trust
  Tiregon Leasing, Inc.
  Interscience, Inc.

Saturn Petroleum Co.
Birmingham, Michigan

Donald Gruber
Waco, Nebraska
dba/Circle "G" Farms

Panhandle Drilling
Hay Springs, Nebraska

Lowell Anderson
Casper, Wyoming
dba/Casper Press
  Liberty Trust
  We The People

Eldor & Ida Miller
Hazen, North Dakota
dba/Nature Nook Trust

Jean & Agnes Bertrand
Peyton, Colorado
dba/Buck Horn Ranch Trust

Thomas C. Woodward
Casper, Wyoming

Forty Four Trust
Hay Springs, Nebraska

Bold Trust
Nebraska

Southwest Farms
Melrose, Minnesota

The Subcommittee conducted an analysis of the account activity of these entities.

Account	Negotiated at Oxford	Withdrawn from Oxford	Number of Transactions	Period Covered
Dr. W.E. Sedivy Agri Nutrition	$ 62,421.92	$ 26,135.12	36	9/78 - 3/79
Eldor & Ida Miller	$ 7,712.54	$ 12,655.00	17	6/78 - 1/79
Nature Nook Trust	$ 12,737.95	$ 9,048.20	398	
Ray & Vera Michel				
R.G. & Vera D. Michel Trust	$472,459.51	/	7	6/78 - 8/78
Tiregon Leasing	/	$242,000.00	7	10/78 - 3/79
Interscience, Inc.	/	$ 85,000.00	4	10/78 - 12/78
Jean & Agnes Bertrand Buck Horn Ranch Trust	$ 5,491.79	/	10	8/78 - 10/78
Thomas Woodward	$ 46,936.60	/	3	9/78 - 10/78
Saturn Petroleum Co.	$378,929.00	/	9	12/77 - 8/78
Forty Four Trust	$ 2,365.85	$ 36,178.92	15	4/78 - 12/78
Bold Trust	$ 37,862.85	/	18	5/78 - 12/78
Southwest Farms	/	$107,112.45	6	1/79 - 3/79
Donald Gruber Circle "G" Farms	/	$278,618.40	4	1/79 - 3/79
Panhandle Drilling	$ 11,904.21	/	15	10/78 - 11/78
Lowell Anderson Liberty Trust	$ 33,877.55	$ 37,500.00	56	4/78 - 1/79
Totals	$1,072,699.77	$834,248.09	605	12/77 - 3/79

Subcommittee staff began in July 1982 to attempt to contact and interview these account holders. But after extreme effort we succeeded in arranging only one personal interview, with Dr. W. E. Sedivy of Nebraska. All other account holders either indicated their intent to plead the fifth amendment or avoided contact with PSI.

Summary

Our investigation of these 11 Oxford Bank account holders revealed:

1. At least six of these individuals appear to be associated in some way with the agriculture industry.
2. At least nine are or have been under IRS and/or grand jury investigation.
3. Lowell Anderson, a tax protest leader, is involved in some way with at least six of the account holders.
4. Anderson sold offshore trusts to at least three of these account holders.

Clearly these similarities and connections are not coincidental. Other government sources confirm that the responses we received from these individuals are similar to the responses given by those in the tax protest movement.

Our investigation focused on only a handful of individuals, believed to be "average" American citizens, involved with one small bank in the British West Indies. This and other evidence collected to date indicates the involvement of average U.S. citizens in offshore banking is widespread and growing. If the above cases are indicative, the amount of money involved could be enormous.

During our investigation of U. S. account holders of the Oxford Bank, we developed several confidential sources of information who described the tax protest movement and its involvement with offshore banking.

According to an April 11, 1982 article by Jon Fleming in the Pittsburgh Press, the number of illegal tax protestors has more than quadrupled in three years, the IRS reported--from 6,000 in 1978 to 27,300 in 1981. The article identifies Dr. Martin A. Larson, age 85, as "the elder statesman of the tax rebellion," says he has been involved since 1945, and says of him: "Larson is college educated. He has a doctorate in English literature from the University of Michigan...He is on the board of the Liberty Lobby in Washington." Larson has written several books on tax resistance. Unlike Larson, the majority of tax protestors lack extensive formal education. However, they are well versed in taxation, the IRS and the U. S. Constitution.

The Subcommittee staff has found that certain individuals, motivated by financial gain, exploit the anti-IRS biases of some of their fellow citizens and enflame their distrust of the U. S. government, the banking industry and most especially the IRS. By promoting the secrecy and security aspects of offshore banking, these con men persuade susceptible individuals that they can legally avoid taxation by placing their assets in an offshore trust. For a few hundred dollars a trust is created in an obscure place like the Turks and Caicos Islands and is then sold for several thousand dollars to an individual in the U.S. (The Subcommittee has information that one trust cost the individual buyer up to $20,000.) A trust account is established with a bank, such as the Oxford Bank, to facilitate deposits and withdrawals from the trust.

The promoters of these trust schemes emphasize that strict secrecy laws of the offshore country shield the identity of the trust owner and thereby insulate him and his assets from taxation and investigation by the IRS. If the indiviudal has difficulties with the IRS, the con men continue their exploitation by advising how the IRS can be expected to proceed and how the taxpayer should respond. When the IRS proceeds exactly as advised, the trust owner's faith in these con men is reinforced.

This faith is not shaken by law enforcement's discovery of their financial activities. They seem committed as ever to their ideological principles. The almost total lack of cooperation with our investigation illustrates this commitment. Despite their admission of having been duped by con men who took large sums of their money and of having been brought into serious conflict with the IRS, not one of these individuals would testify about his experiences or identify the source of his problems.

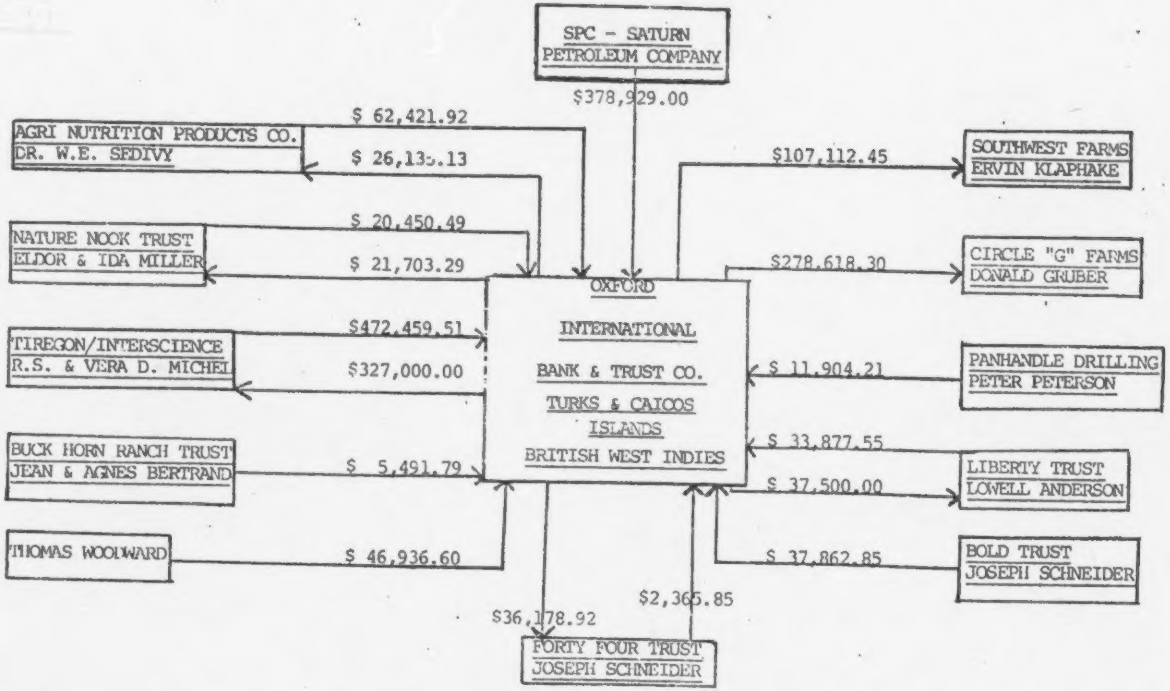
The Oxford Bank phase of our investigation raised questions as it answered others. For this reason we are continuing our inquiry into these areas:

1. An Association which is alleged by Subcommittee sources to be involved in the conversion of its members' dollars into gold and silver. The concept of ensuring the value of one's money through the purchase of precious metals is attractive to people who distrust the American banking system and question the legality of the U.S. dollar.

2. The Subcommittee staff is concerned about evidence indicating that certain protest groups are becoming more radical and arming themselves with

automatic weapons. This evidence was tragically brought to nationwide attention in mid-February 1983, when two U.S. Marshalls were killed and three other officers were wounded in a burst of automatic weapons fire while attempting to arrest Gordon Kahl, a convicted tax protester, for parole violations. Kahl is a member of the Posse Comitatas tax protest group. Lowell Anderson, a central figure in our investigation is also an admitted member of the posse comitatas.

CASE STUDY: MID-AMERICA GOES OFFSHORE


SPC - SATURN PETROLEUM COMPANY
$378,929.00
OXFORD INTERNATIONAL BANK & TRUST CO. TURKS & CAICOS ISLANDS BRITISH WEST INDIES
AGRI NUTRITION PRODUCTS CO. DR. W.E. SEDIVY
$ 62,421.92
$ 26,135.13
NATURE NOOK TRUST ELDOR & IDA MILLER
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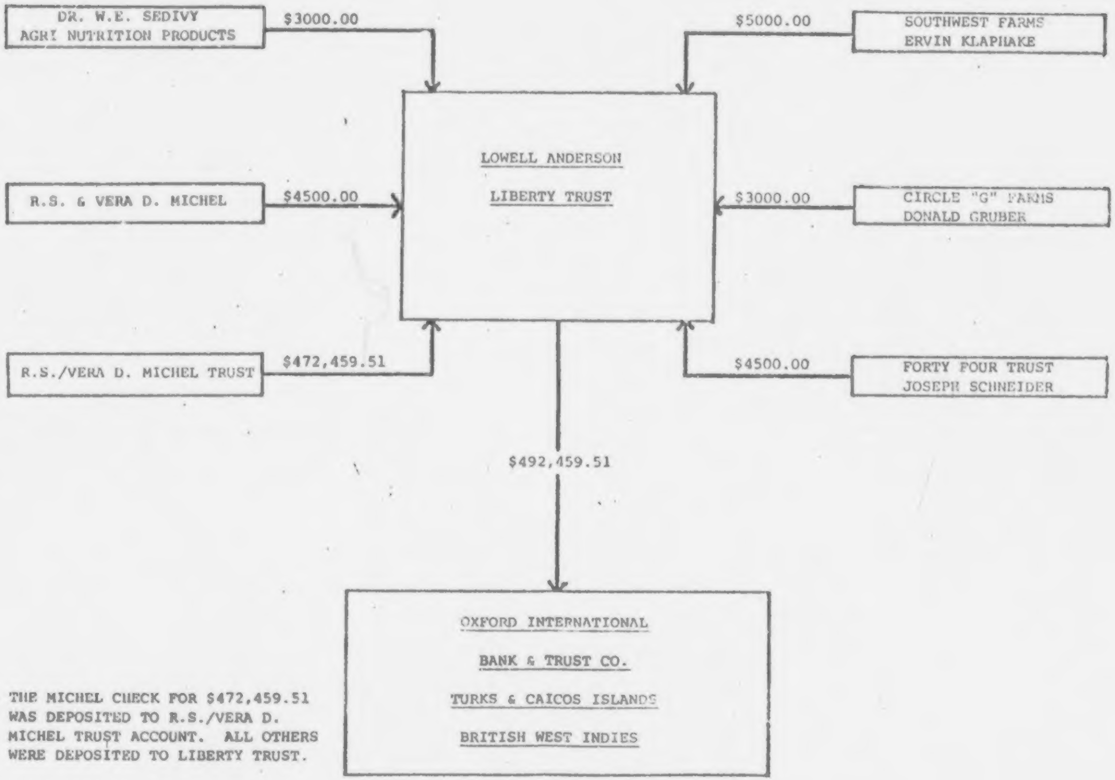
WITHDRAWN=$834,248.09

PAYMENTS TO ALLEGED TAX PROTEST LEADER USING OFFSHORE BANK


DR. W.E. SEDIVY
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R.S./VERA D. MICHEL TRUST
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JOSEPH SCHNEIDER
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NOTE: THE MICHEL CHECK FOR $472,459.51 WAS DEPOSITED TO R.S./VERA D. MICHEL TRUST ACCOUNT. ALL OTHERS WERE DEPOSITED TO LIBERTY TRUST.

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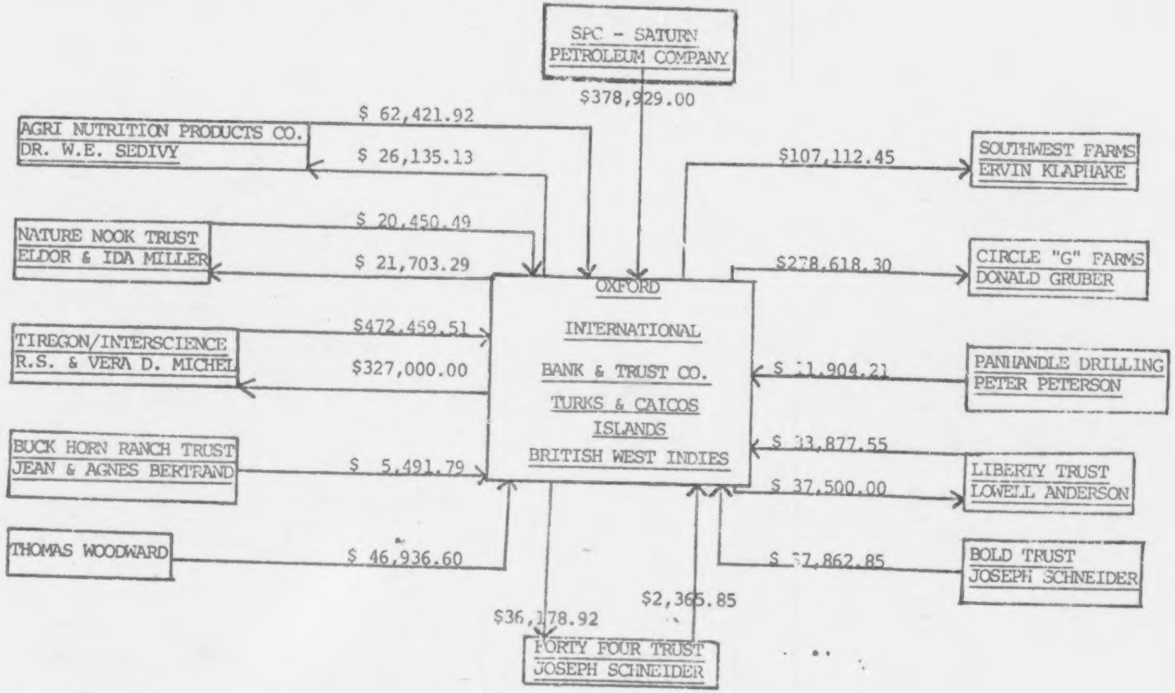
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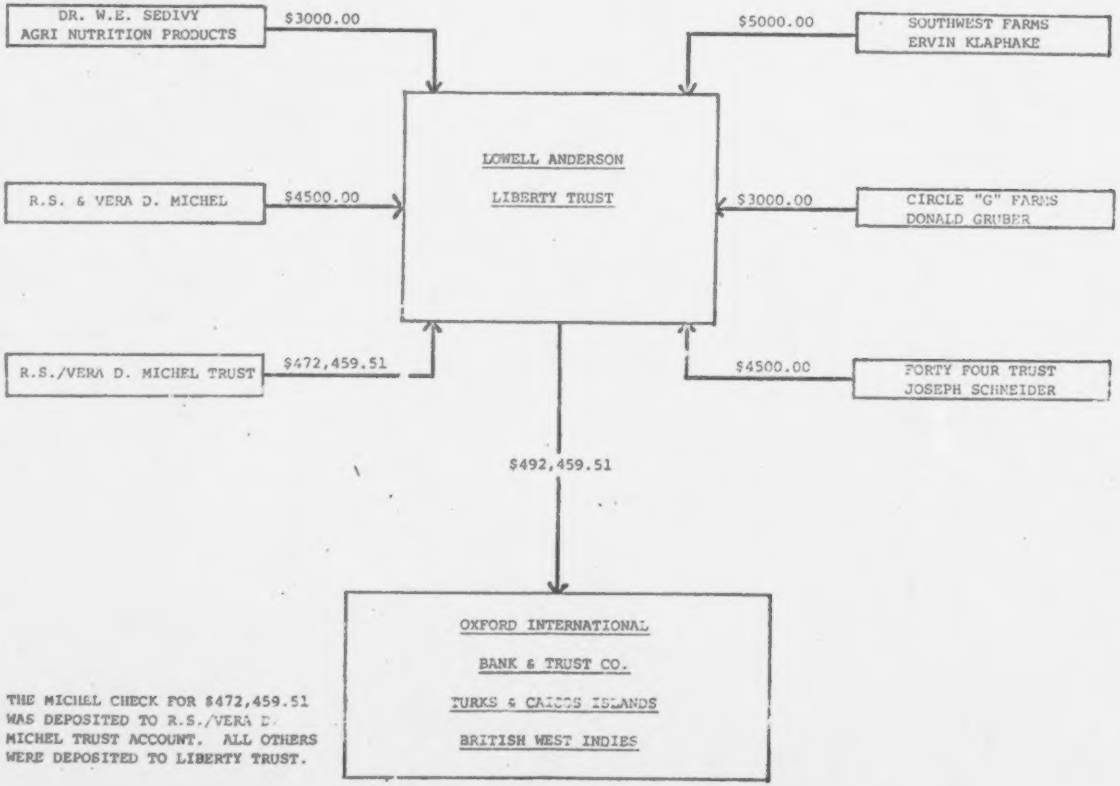
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DIVISION OF
ENFORCEMENT

PREPARED STATEMENT OF JOHN M. FEDDERS, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION

May 24, 1983

This statement is submitted as the Permanent Subcommittee on Investigations continues its inquiry into the relationships between crime, secrecy and the use of offshore banks and companies. It addresses the subject in light of the Securities and Exchange Commission's experience in enforcing the federal securities laws.

Summary

Foreign participation in the U.S. securities markets has increased dramatically. It should be encouraged. In 1982, stock and bond transactions in our capital markets by foreign financial institutions exceeded $53 billion.

Enforcement of the U.S. securities laws is often frustrated by foreign secrecy and blocking statutes. 1/ There are over 15 jurisdictions with secrecy laws and 16 jurisdictions with blocking laws, all of which have access to the U.S. markets.

When transactions are effected through foreign financial institutions, the Commission is often unable to obtain the information needed to proceed with an investigation. Persons who effect transactions through such intermediaries have been able to conceal their identities and impede investigations of their conduct.

This use of secrecy and blocking laws to hide violations of U.S. laws has created a *de facto* double standard for enforcement of the securities laws. One standard exists for those trading within the U.S., and a lesser standard exists for those trading within the U.S. but from beyond our borders. As securities laws violators increase their use of intermediaries outside our borders, the integrity of the U.S. markets is threatened. The Commission seeks to eradicate this double standard.

The Commission has initiated court actions and employed the Federal Rules of Civil Procedure governing discovery to determine the identities of some customers who conducted illicit trading. This approach has been successful, but it consumes an inordinate amount of Commission resources.

The Commission also has explored diplomatic solutions to the problem. An agreement was reached with the Swiss government and the banks of Switzerland in August 1982.

Additional steps may be required to enable the Commission to protect the U.S. securities markets from fraud and manipulation. Accordingly, this Subcommittee might consider the need for legislation which enhances the Commission's enforcement powers without undermining this country's position as the world's center for capital formation. However, since neither the Division of Enforcement nor the Commission has fully analyzed the cost-effectiveness of possible legislative initiatives, legislation is not recommended at this time.

I. An International Consensus Based on Mutual Respect

A. The Internationalization of the Securities Markets

The internationalization of the securities markets makes the need for improved nation-to-nation law enforcement cooperation a matter of great importance. The markets of each nation -- particularly our own -- are increasingly affected by events initiated outside their borders.

Foreign participation in the U.S. securities markets has increased dramatically. From 1978 to 1982, transactions in the U.S. by foreign financial institutions involving stocks increased from $20.1 billion to $41.8 billion. During the same period, transactions in bonds by such institutions increased from $3.5 billion to $11.3 billion. Total foreign investment in the U.S. increased from $25.6 billion in 1971 to $42.4 billion in 1978 and to $99.2 billion in 1982. 2/

In addition, U.S. investors are an increasingly important source of capital for foreign nations. During the past six months, since the Commission instituted a new short form registration statement, 11 foreign companies have registered with the Commission approximately $1.2 billion in offerings. At the end of 1982, 250 foreign issuers and 12 foreign governments had securities registered with the Commission.

It soon will be possible to trade many securities of U.S. corporations 24 hours a day as a result of improved international communications and the growth of securities markets in London, Paris, Zurich, Singapore, Hong Kong, Tokyo and other financial centers.

There is a rise in transactions in our capital markets from jurisdictions which have secrecy or blocking laws. That is not to say that all, or even a small part, of the business which comes to the U.S. through those jurisdictions is fraudulent. Because secrecy laws reduce the Commission's ability to police the markets and thereby insure their integrity, the way has been opened for a few wrongdoers to threaten the fairness of our capital markets. Effective enforcement is essential so that all who seek to save and invest in our markets will have confidence they are fair and honest.

B. Effective Enforcement Tools

The availability of the U.S. markets to people of all nations presents a challenge to the Commission's efforts to protect the public and maintain the integrity of those markets. Enforcement of the securities laws is complicated by the use of foreign banks and broker-dealers which are prevented from cooperating with Commission investigations and enforcement actions by the laws of their countries. 3/

Foreign bank secrecy statutes have long been recognized as a significant impediment to enforcement efforts. As noted by Congress in 1970:

> Secret foreign bank accounts and secret foreign financial institutions have permitted a proliferation of "white collar" crime . . . [and] have allowed Americans and others to avoid the laws and regulations concerning securities and exchanges . . . . The debilitating effects of the use of these secret institutions on Americans and on the American economy are vast. 4/

Similarly, blocking statutes often prevent the Commission from gaining access to information held by foreign institutions.

The Commission has encountered significant problems as the result of secrecy and blocking laws while investigating cases dealing with (i) insider trading, 5/ (ii) failures to comply with the disclosure requirements concerning acquisitions of corporate control, 6/ (iii) schemes to manipulate the market price of a security, 7/ (iv) schemes to sell securities in the U.S. in violation of the registration requirements of the Securities Act of 1933, 8/ (v) the making of questionable or illegal payments, 9/ (vi) the looting of corporate assets 10/ and (vii) the "laundering" of funds generated by other illegal activities. 11/

If the Commission is to fulfill its statutory mandate to protect investors and the fairness and integrity of the domestic securities markets, the Commission's staff must be able to determine the identity of suspect purchasers and the facts surrounding the transactions.

C. Foreign Secrecy and Blocking Laws Versus U.S. Securities Laws: A Collision of Interests?

At issue is the sovereignty of the U.S., and the Commission's ability to preserve the integrity of our securities markets.

I am not (i) proposing extraterritorial application of U.S. laws or (ii) threatening the sovereignty of other nations. I am, in fact, addressing extraterritorial application of foreign laws to impede and frustrate the Commission's efforts to preserve the integrity of our capital markets.

Foreign financial institutions effecting transactions on the U.S. securities markets engage in conduct within the U.S. The conduct is a deliberate "invasion" of the territory of the U.S. If secrecy or blocking laws are asserted to cloak the transactions and impede our investigations, then there is an affirmative infringement of U.S. sovereignty and the Commission's mandate to preserve the integrity of our markets.

The Supreme Court has held that a defendant will be found to have submitted to the jurisdiction of a state when the "defendant purposefully avails itself of the privilege of conducting activities within the foreign state, thus invoking the benefits and protections of its laws." 12/

By effecting a securities transaction in the U.S., a foreign financial institution and its customers deliberately avail themselves of the privilege of conducting activities here, and "invoke the benefits and protections" of the U.S. securities markets and of U.S. law. They should accept the responsibilities associated with the exercise of that privilege.

Foreign secrecy or blocking laws should not be given extra-territorial effect to cloak transactions that occur in the U.S. Other nations should recognize that it is the customer's voluntary choice to cause a financial institution to engage in conduct in the U.S., outside its jurisdiction and outside the ambit of any secrecy or blocking laws that might otherwise be applicable within its territory. Moreover, they should recognize that the act of trading securities outside the territory of a secrecy jurisdiction constitutes a waiver of any applicable secrecy or blocking provisions that the customer or an agent may waive.

The approach suggested is consistent with the principle of international comity. It accords due respect to the sovereignty and laws of nations that have secrecy laws, while providing a basis for vindicating the sovereignty of the U.S. and the integrity of its securities markets.

II. The Present Situation

A. Confronting The Problem

The Commission investigates a wide range of market activity and corporate disclosure. Normally, where suspicious transactions occur, the enforcement staff will request the trading records of the broker and customer involved and take testimony to determine whether illegal conduct occurred. Similar action is taken when investigating corporate disclosure.

However, when a suspicious transaction is executed by a bank located in a secrecy or blocking statute jurisdiction, our ability to investigate is greatly diminished. We also are frustrated when seeking records of a foreign subsidiary of a U.S.-based multinational corporation. A claim of protection by foreign secrecy or blocking laws is often interposed. This frustrates the Commission's ability to conduct an inquiry.

The process by which an individual may evade the U.S. securities laws by using a foreign bank as an intermediary has been described by one former prosecutor as follows:

> Most Swiss banks have very large, very active accounts with brokers in New York. These accounts are maintained in the name of the Swiss bank. The securities of all the bank's customers may be lumped in together and there is no record at the New York broker of the identities of the bank's customers, the true owners of the securities 13/

Bank secrecy generally prevents the Commission from obtaining information from banks involved in such trading. This same situation exists where the Commission confronts a blocking law.

B. Resource Constraints

The Commission's enforcement staff has developed an expertise in foreign discovery practices and the effects of foreign blocking and secrecy laws in its effort to carry out its statutory mandate while respecting the sovereignty of foreign nations. 14/ The enforcement efforts often have been delayed or frustrated by foreign laws. Indeed, once a foreign subsidiary of a U.S. based multinational or a non-resident of this country becomes involved in one of our investigations or lawsuits, the complications and costs mount rapidly.

In order to strip away the veil provided by foreign laws, the Commission must allocate an inordinate amount of resources and manpower to the task. This commitment of resources puts a strain on other enforcement efforts.

C. The Santa Fe Case

An example is SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe International Corporation, (the "Santa Fe case"), which involved purchases of common stock and call options for the common stock of the Santa Fe International Corporation immediately prior to the public announcement of a merger between Santa Fe and the Kuwait Petroleum Corporation. Various banks purchased the securities for their own omnibus accounts and refused to divulge the names of the principals for whom they engaged in the transactions.

In the Santa Fe case, the Commission has been seeking the identities of the unknown purchasers since October 26, 1981, when the case was filed. After lengthy discussions with the defendants' counsel and the government of Switzerland, a decision was made to apply for assistance pursuant to the 1977 U.S.-Swiss Treaty on Mutual Assistance in Criminal Matters. That request was made in March 1982. In January 1983, the Swiss Federal Tribunal denied the requested assistance. Since that time the Commission has sought other avenues, short of compulsory measures, to learn the customers' identities. To date, efforts have failed. As a result, the litigation has been stalled while an inordinate amount of resources has been consumed.

D. The St. Joe Case

SEC v. Banca della Svizzera Italiana, (the "St. Joe" case) involved transactions in the common stock and call options for the common stock of St. Joe Minerals Corporation just prior to the announcement of a take-over bid for that corporation. It is one of the most significant achievements the Commission has had in combating foreign secrecy laws through litigation.

After the bank in that case refused to provide needed information, the Commission made an effort through the Departments of State and Justice and the Swiss authorities to use non-compulsory means to learn the customers' identities. No such solutions were available. As a result, in October 1981, a motion seeking to compel production of the requested information was filed in federal court.

In November 1981, Judge Milton Pollack of the U.S. District Court for the Southern District of New York granted the Commission's motion and ordered the bank to either disclose its customers' identities or risk substantial sanctions.

Using Section 40 of the Restatement of Foreign Relations Law, 15/ Judge Pollack balanced the vital national interests at stake, the hardship which would be imposed by the decision and the good faith of the parties.

He stated,

> "The strength of the United States interest in enforcing its securities laws to insure the integrity of its financial markets cannot seriously be doubted. That interest is being continually thwarted by the use of foreign bank accounts." 16/

He concluded that:

> "It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law." 17/

The bank subsequently obtained a waiver from its customer and produced the requested information.

E. Securities Laws: Protecting a Vital National Interest

The securities laws represent a "vital national interest" for the U.S. 18/ Judge Pollack's opinion is a significant precedent, but it is of limited utility. A case-by-case method for analyzing whether production of information will be compelled does not provide the most effective deterrent against securities laws violators. It is an extraordinary solution for an extraordinary case. Unless potential violators are deterred by the fear that their transactions will be scrutinized, they will continue to use foreign secrecy and blocking laws to hide fraudulent transactions and their identities.

This problem is not solely one of resources. While greater enforcement resources would enhance our efforts, such increases would be band-aid solutions.

III. International Solutions

While we do not wish to impede capital formation or the continued internationalization of our securities markets, the integrity of our markets and corporate disclosure systems must be maintained. Workable solutions must be sensitive both to the needs of enforcement and to the sovereignty of other nations.

A. The Mutual Assistance Treaty With Switzerland

The Commission has sought international solutions to its enforcement problems. Members of the Commission's staff assisted in the negotiation of the 1977 Treaty on Mutual Assistance in Criminal Matters with Switzerland.

The government of Switzerland has played a leading role in forging innovative solutions. Their efforts have been responsible for much of the progress made in this area.

The treaty provides for assistance in locating witnesses, obtaining statements and testimony and the production and authentication of judicial and administrative documents. While the treaty has served to deter the use of Swiss secrecy laws to conceal fraud, its benefits for securities enforcement have been limited. Compulsory assistance is needed to overcome Swiss bank secrecy laws, but is only available under the Treaty for conduct which constitutes a criminal offense under the laws of both nations.

For many cases, such as those involving inadequate disclosure of ownership interests or trading on the basis of material nonpublic information, the treaty mechanism may not be available. This is largely because of its requirement of "dual criminality": the violation must be criminal in the U.S. and Switzerland. Thus, in the Santa Fe case, the Commission's request for information regarding suspect transactions was denied because, while Swiss law made it illegal for tippees to trade on insider information, it is not illegal for insiders to use that information.

The treaty requires a substantial amount of time both to prepare the request for assistance and to obtain the requested information. For example, in the Santa Fe case, our request was made in March 1982, and the decision denying the request was made in January 1983. Other cases have taken longer.

In many Commission cases, time is of the essence. When it takes 10 to 12 months to receive information, the Commission's ability to pursue a case is seriously impaired. As a result, while the Treaty provides a useful mechanism for mutual assistance, its application to the types of problems the Commission encounters is not a complete solution.

Switzerland is considering legislation to make insider trading illegal, which would have the effect of making the Treaty available in all cases involving the purchase or sale of securities by persons in possession of material nonpublic information.

B. The Memorandum of Understanding and Private Agreement

In August 1982, the Commission concluded six months of consultations with the government of Switzerland. A Memorandum of Understanding ("MOU") was executed to supplement the 1977 Treaty.

The U.S.-Swiss MOU represents a landmark agreement. It demonstrates what can be achieved by two nations in the area of mutual law enforcement cooperation. It provides an important vehicle for the Commission when investigating insider trading cases where Swiss accounts have been utilized.

The MOU provided that, for certain insider trading cases in which information cannot be obtained under the 1977 Mutual Assistance Treaty, a private agreement among members of the Swiss Bankers' Association who trade on U.S. securities markets will apply. This private agreement, known as Convention XVI, provides an alternative method for supplying information to the Commission, notwithstanding the secrecy law, in insider information cases involving a tender offer or other business acquisition.

It has been agreed that the private agreement will remain in effect until the Swiss government amends its penal and civil laws to include "insider trading." At that time, the Commission will be able to utilize the 1977 Mutual Assistance Treaty to obtain the necessary information. Should no such law be passed, the agreement will remain in effect for three years, unless renewed.

It must be emphasized that the Swiss have shown great interest in devising methods to assist the Commission in fulfilling its mandate. I have the highest regard for their good faith. Their efforts deserve great praise and respect. Without their commitment to finding a solution to this problem, our consultations would not have succeeded.

IV. The Search for Broader Solutions

The Commission's vitality as an enforcement agency depends on its ability to quickly investigate suspect activity in the securities markets.

While the Mutual Assistance Treaty and the MOU between the U.S. and Switzerland provide viable means for combating those who utilize Swiss accounts to circumvent the U.S. securities laws, they do not apply to all violations of the securities laws. Further, these discovery mechanisms are only available when a particular Swiss account is implicated in a transaction.

There are many nations which offer anonymity to investors with respect to banking and financial transactions. It would be impractical for the Commission to negotiate separate disclosure agreements with each nation that has secrecy or blocking statutes. Further, the remedy available under Rule 37 of the Federal Rules of Civil Procedure, which was employed in the *St. Joe* case, can only be applied on a case-by-case basis after a civil enforcement action has been filed. This approach is slow and cumbersome. It is not available in Commission private investigations. To be effective, the Commission must be able to act quickly in investigating a case.

Your staff has requested that I pose questions for this Subcommittee to consider during its important deliberations. They asked that I raise issues concerning possible legislation to assist the Commission's enforcement efforts. Before I pose questions, I want to point out that the questions are my own and do not necessarily represent the views of Chairman Shad, the Commission, the President, or the Office of Management and Budget.

The four questions are:

First, does the Commission need legislation that will put all persons on notice, and provide by operation of law, that the act of effecting a securities transaction in the U.S. constitutes a waiver of any secrecy provisions that a person or an agent may waive?

Second, does the Commission need improved means for obtaining the assistance of a federal court during an investigation in requesting and obtaining information from persons or institutions located overseas? At the present time, the Commission can use its administrative subpoenas only if a person or entity can be found within the U.S. and must rely, when dealing with persons located abroad, on voluntary cooperation, or, where available, bilateral or multilateral international agreements -- options which are time-consuming and resource intensive.

Third, would it be helpful if legislation were enacted providing that the act of effecting a securities transaction in the U.S. shall constitute the appointment of the U.S. broker-dealer involved as an agent for service of process with respect to any Commission enforcement action or any statutory action that might be initiated to assist the Commission in seeking information in the course of its investigations?

Fourth, should legislation be enacted providing that the act of effecting a securities transaction in the U.S. shall constitute a consent to the jurisdiction of the U.S. with respect to any action that might arise out of the transactions?

Since neither the Commission nor the Division of Enforcement has fully analyzed the cost-effectiveness and relative merits of affirmative answers to these questions, legislation is not recommended at this time. The following are areas that warrant further consideration.

A. Approaches

1. The Waiver By Conduct Approach

The Congress might consider enacting legislation declaring, as a matter of U.S. law, that the act of trading securities in the U.S. shall constitute a waiver of any otherwise applicable secrecy or blocking laws that a person or an agent may waive. In addition, the legislation could require that brokers or dealers effecting transactions on behalf of persons or institutions located abroad provide notice that the act of trading will be deemed to constitute such a waiver.

As an additional step, the Congress might provide that the act of effecting a transaction in the U.S. shall be deemed to constitute a consent to service of process and an appointment of the broker or dealer that effected a transaction as an agent for service of process in connection with any court action arising out of the transactions.

This approach might establish rules of general applicability. In addition, it would appear to be consistent with the principle of international comity. 19/

The "waiver by conduct" principle is also consistent with the results of our negotiations with the Government of Switzerland. For example, as part of efforts to implement the Private Agreement, Swiss banks have advised their customers that, if they continue to give orders to the bank for execution on U.S. markets, their remitting the order is automatically considered as being approval of the stipulations of Convention XVI of the Swiss Bankers' Association. Fundamentally, the customer of the Swiss bank agrees that if he places an order through the bank for execution in the U.S. capital markets -- and if the Commission requests his identity and a special Swiss commission agrees -- the customer consents to the information being provided to the Commission. While enactment of legislation based on a waiver by conduct approach would involve a more complete waiver than the one used to implement the Private Agreement, it could employ the same principle.

The Commission is not presently recommending this or any other possible legislation.

2. Proposed Amendment to 21(c) Of the Securities Exchange Act

In the mid-1970's, the Commission advocated a possible legislative solution in response to problems it had encountered in investigations involving foreign persons or entities. The proposal contemplated that a request for information would be submitted to a foreign financial institution and that a procedure analogous to a subpoena enforcement action could be pursued in the event the Commission did not receive needed information. The legislation would have authorized U.S. courts to impose sanctions for refusal to provide information or evidence, on the beneficial owners of securities that are the subject of an investigation. Sanctions would have included:

> impoundment or withholding of any dividends or interest otherwise due any person from whom the Commission has failed to receive information;
>
> revocation or suspension of voting rights with respect to any person from whom the Commission has failed to receive information; and
>
> an order to any issuer or transfer agent to refrain from effecting a registration or transfer with respect to a particular purchase or sale by any person having an interest in the securities involved until the information sought from such person is furnished to the Commission.

The sanctions contemplated could have been ordered and enforced within the territory of the U.S., thereby avoiding jurisdictional conflicts with other nations.

The proposal was innovative. However, it did not adequately address either the means of serving a request for information on a foreign financial institution or the procedure for enforcing such a request in a federal court. 20/

The Walsh Act 21/ may provide a procedural model that could remedy some of the deficiencies in the earlier proposal to amend Section 21(c) of the Securities Exchange Act of 1934.

The Walsh Act authorizes the filing of a civil action in a federal court seeking testimony and other evidence from U.S. nationals and residents who are found abroad. Subpoenas issued under the Walsh Act are to be served in accordance with the provisions of the Federal Rules of Civil Procedure relating to service of process on a person in a foreign country. It is important to note that the Walsh Act may be used in an investigative context, such as a grand jury proceeding. 22/

3. Proposed Rule 17a-3(a)(9)

The "waiver by conduct" approach would condition access to the U.S. securities markets upon customer waivers of foreign secrecy provisions. A different, but conceptually similar approach, is contained in proposed Rule 17a-3(a)(9). 23/ The proposed amendment would have required, as a precondition to participation in U.S. securities markets, that those who act on behalf of undisclosed principals establish in advance, by written agreement, their willingness to disclose the identity of their principals in response to a Commission request. Brokers and dealers would have been required to obtain the agreement of financial institutions or other persons authorized to effect transactions for the account that such persons will furnish the name and address of the beneficial owners at the request of the Commission.

Public comments concerning this proposal were negative. Among other things, it was suggested that the rule would drive securities business offshore, could easily be evaded and would place undue burdens on brokers and dealers. The proposed rule has neither been adopted nor withdrawn since the comment period closed.

4. CFTC Rules Concerning Special Calls

The rules of the Commodity Futures Trading Commission contain another approach, which conditions access to the U.S. futures markets upon a willingness to provide information in response to a specific request of the CFTC. The rules permit the CFTC to issue "special calls" requesting information from futures commission merchants, foreign brokers, and members of the contract markets. The rules require that futures commission merchants provide the name, address and certain information concerning the holder, or beneficial holder, of an open futures contract, in response to such a special call. 24/

The CFTC's rules also provide that, when a customer of a futures commission merchant is a foreign broker or trader, the merchant is "deemed to be the agent of the foreign broker or the foreign trader for the purpose of accepting delivery and service of any communication . . . [the CFTC may send] to the foreign broker or foreign trader . . . ." 25/ Service of any communication on a foreign broker or trader is effective when made upon the futures commission merchant, who is required promptly to transmit the communication to the principal involved. The futures commission merchant also is deemed the agent for any customers of a foreign broker. Thus, the CFTC's special call provisions avoid many of the problems inherent in effecting service of process upon a resident of another country.

When a futures commission merchant or a customer has refused to comply with a special call, the CFTC can prohibit the contract market involved, and all futures commission merchants and foreign brokers, from executing or accepting any orders for trades on that contract market or for the specific contracts in question (except for trades closing out the positions involved). Thus, a special call may be enforced even when the person served is neither physically present in the U.S., nor owns any property within the U.S.

VI. Conclusion

Maintenance of the integrity of the U.S. capital markets requires vigorous enforcement of the securities laws. This is essential to maintain investor confidence that the marketplace is fair and honest.

As it stands now, there are two sets of rules: one for trading within the U.S., and a lesser standard for those trading from beyond our borders. We must send a clear message to all persons who use the securities markets of the U.S.: "We welcome your participation, but you cannot expect preferential treatment. If you want to trade in our markets, you must agree to play by our rules."

FOOTNOTES

1/ Secrecy laws are confidentiality laws which prohibit the disclosure of business records or the identity of financial institutions. Blocking laws prohibit the disclosure, copying, inspection or removal of documents located in the territory of the enacting state in compliance with orders of foreign authorities. They impede judicial or administrative proceedings by restricting testimony or production of documents for use in such proceedings.

2/ Treasury Bulletin, Bureau of Government Financial Operations, Office of the Secretary, Department of the Treasury, Winter Issue; 106-109; SEC Monthly Statistical Review, Vol. 42 No. 2, p. 5 (February 1983).

3/ See, e.g. The Bahama Islands, An Act to Regulate Banking Business and Trust Companies within the Colony. No. 64 of 1965, Assented to Oct. 28, 1965:

> "10. (1) Except for the purpose of the performance of his duties or the exercise of his functions under this Act or when lawfully required to do so by any court of competent jurisdiction within the Colony or under the provisions of any law of the Colony, no person shall disclose any information relating to any application by any person under the provisions of this Act or to the affairs of a licensee or of any customer of a licensee which he has acquired in the performance of his duties or the exercise of his functions under this Act.
>
> "(2) Every person who contravenes the provisions of subsection (1) of this section shall be guilty of an offence against this act and shall be liable on summary conviction to a fine not exceeding one thousand pounds or to a term of imprisonment not exceeding one year or to both such fine and imprisonment.":

The Cayman Islands, The Confidential Relationships (Preservation) Law (Law 16 of 1976), September 27, 1976 as amended October 2, 1979.

> "4b. [Whoever] wilfully obtains or attempts to obtain confidential information to which he is not entitled is guilty of an offense and liable on summary conviction to a fine not exceeding $5,000 or to imprisonment for a term not exceeding 2 years or both."

FOOTNOTES - Cont.

Article 47(b) of the Swiss Banking Act,

> "1. Anyone who in his capacity as an officer or employee of a bank, or as an auditor or his employee, or as a member of the banking commission or as an officer or employee of its bureau intentionally violates his duty to observe silence or his professional rule of secrecy or anyone who induces or attempts to induce a person to commit any such offense, shall be liable to a fine of up to 50,000 francs or imprisonment for up to six months, of both.
>
> "2. If the offender acted with negligence, he shall be liable to a fine of up to 30,000 francs.
>
> "3. The violation of professional secrecy is also punishable after the termination of the official or contractual relationship or of the professional performance.
>
> "4. The federal or cantonal dispositions on the obligation to testify or to provide an authority with information remain reserved."

In addition, Article 273 of the Swiss Penal Code prohibits the disclosure to a foreign authority or foreign private person of information of an economic nature if there is a direct interest of Switzerland as a political or economic entity to keep this information secret, or if third persons, having an interest worth being protected in keeping the information secret, have not duly given in advance their consent to the disclosure.

4/ H.R. Rep. No. 975, 91 Cong. 2d Sess. 12 reprinted in [1970] in U.S. Cong. & Admin. News, 4394, 4397.

5/ SEC v. Certain Unknown Purchasers etc. et al., 81 Civ. 6553 (S.D.N.Y.) (WCC). SEC v. Banca della Svizzera Italiana et al., 92 F.R.D. 111 (S.D.N.Y. 1981).

6/ See e.g. SEC v. General Refractories Co., 400 F. Supp. 1248 (D.D.C., 1975) and SEC v. Banque de Paris et des Pays-Bas (Suisse) S.A. (D.D.C., 77 Civ. 798).

FOOTNOTES - Cont.

7/ See e.g. SEC v. Everest Management Corp., et al., 71 Civ. 4932; SEC v. Edward M. Gilbert, et al., 82 F.R.D. 723 (S.D.N.Y., 1979).

8/ See e.g. SEC v. American Institute Counselors, Inc., et al. (D.D.C., 75 Civ. 1965).

9/ See e.g. SEC v. Lockheed Aircraft Corp., et al. (D.D.C., 76 Civ. 611); SEC v. The Goodyear Tire & Rubber Co., (D.D.C., 77 Civ. 2167).

10/ SEC v. Robert L. Vesco., et al. (S.D.N.Y., 72 Civ. 5001).

11/ SEC v. Kasser, 548 F.2d 109 (3rd Cir. 1972).

12/ See Hanson v. Denckla, 357 U.S. 235, 253 (1957); Shaffer v. Heitner, 433 U.S. 186, 213-16 (1977).

13/ Proposed Amendments to the Federal Deposit Insurance Act; Hearings on H.R. 15073 Before the House Committee on Banking and Currency, 91st Congress, 1st & 2d Sess. 12 (1969-1970) (Statement of Pierre Leval, former Chief Attorney, Appellate Division, S.D.N.Y.).

14/ Some foreign countries consider it a violation of their sovereignty for another country's government to request one of its residents to perform an act within that foreign country's borders. For example, Section 271 of the Swiss Penal Code states:

> "(1) Whoever performs, without permission, acts for a foreign state on Swiss territory which are within the authority of an administrative agency or a public official,
>
> "whoever performs such acts on behalf of a foreign party or another foreign organization,
>
> "whoever furthers such acts,
>
> "will be punished by imprisonment, in grave cases by confinement in a penitentiary."

FOOTNOTES - Cont.

This law has been construed to make illegal certain official contacts by U.S. government employees or agents, including mailing documents to, or telephoning persons in, Switzerland, or meeting with residents while visiting that nation.

15/ Section 40 Restatement (Second) of Foreign Relations Law (1965):

> "Limitations on Exercise of Enforcement Jurisdiction
>
> Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as
>
> (a) vital national interests of each of the states,
>
> (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
>
> (c) the extent to which the required conduct is to take place in the territory of the other state,
>
> (d) the nationality of the persons, and
>
> (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state."

16/ 92 F.R.D. at 117.

17/ *Id*. at 119.

FOOTNOTES - Cont.

18/ Section 2 of the Securities Exchange Act of 1934 [15 USC 78b] states:

> ". . . transactions in securities as commonly conducted upon securities exchanges and over the counter markets are affected with a national public interest which makes it necessary to provide for regulation . . . .

Among the justifications for the enactment of this legislation was the need to prevent the type of "national emergencies" which "are precipitated, intensified, and prolonged by manipulation . . . ."

19/ The U.S. courts held that the Congress "did not mean the United States to be used as a base for fraudulent [securities] schemes even when the victims are foreigners." Bersch v. Drexel Firestone, Inc., 519 F.2d 974, 987 (2d Cir. 1975). The same principle should govern the relations of other nations with the U.S.

20/ Another approach is contained in Section 982 of the Internal Revenue Code, which was added by the Tax Equity Fiscal Responsibility Act of 1982. Section 982 authorizes the Internal Revenue Service in the course of an audit to serve a taxpayer with a "formal document request" for production of books, records or other documents found outside the U.S. (provided that normal procedures have failed to produce the documents sought). Such requests must be served by registered or certified mail at the taxpayer's last known address. The failure of a taxpayer to "substantially comply" with such a request may preclude the taxpayer from introducing the documents as evidence in a civil proceeding brought by the IRS for unpaid taxes.

21/ 28 U.S.C. §§ 1783 and 1784 (as amended in 1948 and 1968).

22/ See 88th Congress, S.R. 1580, 1964 U.S. Code and Adm. News 3782, 3790 (legislative history for the 1964 amendments to the Walsh Act); see also U.S. v. Danenza, 528 F.2d 390 (2d Cir. 1975). Failure to comply with a subpoena issued pursuant to the Walsh Act subjects the subpoenaed person to contempt proceedings. If the person is found to be in contempt the court can impose a fine of up to $100,000, which may be satisfied through the sale of any property the person holds in the United States.

FOOTNOTES - Cont.

23/ Securities Exchange Act Release No. 12055 8 SEC Docket 1155, 41 F.R. 8075; Securities Exchange Act Release No. 13149, 11 SEC Docket 1416, 42 F.R. 3312.

24/ 17 CFR § 21.

25/ 17 CFR § 15.05.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
ENFORCEMENT

TESTIMONY OF JOHN M. FEDDERS, DIRECTOR,
DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION,
BEFORE THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

May 24, 1983

Senator Roth, members of the Subcommittee:

It is a pleasure to testify about the impact of foreign secrecy and blocking laws on the Securities and Exchange Commission's efforts to protect investors and police the U.S. capital markets. I will address problems encounted in investigations and litigation because of foreign legislation restricting discovery, and explore approaches which may resolve the difficulties.

Secrecy laws are confidentiality laws which prohibit the disclosure of business records or the identity of bank customers. Blocking laws prohibit the disclosure, copying, inspection or removal of documents located in the territory of the enacting state in compliance with orders of foreign authorities.

Internationalization of the Securities Markets

We are in the midst of rapid internationalization of the securities markets. The capital markets of each nation -- particularly our own -- are increasingly affected by events initiated outside their borders.

Foreign participation in the U.S. securities markets has increased dramatically. From 1978 to 1982, transactions in the U.S. by foreign financial institutions involving stocks and bonds increased from $23.6 billion to $53.1 billion. Total foreign investment in the U.S. increased from $25.6 billion in 1971 to $42.4 billion in 1978 and to $99.2 billion in 1982.

Obviously, this increase has been accompanied by a rise in transactions from jurisdictions which have secrecy or blocking laws. I am not implying that all, or even a small part, of the transactions from those jurisdictions are fraudulent. However, their laws impede, and sometimes foreclose, the Commission's ability to monitor our markets and insure their integrity. They provide a means for wrongdoers to threaten the fairness of our market system.

The Commission's Chairman, John S.R. Shad, has said "America's securities markets are by far the best the world has ever known -- the broadest, the most active, efficient and fairest." Our markets also are the best managed, surveilled and policed. It is the fairness of our markets which attracts foreign capital. Without jeopardizing the attractiveness of our markets to foreign investors, we must assure the Commission's ability to maintain the high integrity of those markets.

U.S. Sovereignty

I will discuss how secrecy and blocking laws impede Commission investigations, and our efforts to overcome foreign laws restricting discovery. Before I do, however, I want to emphasize that I am not (i) proposing extraterritorial application of U.S. laws or (ii) threatening the sovereignty of other nations. I am, in fact, addressing extraterritorial application of foreign laws to impede and frustrate the Commission's efforts to preserve the integrity of our capital markets.

At issue is the sovereignty of the U.S., and the Commission's ability to protect investors.

The U.S. Supreme Court has articulated the principal that those who purposefully avail themselves of the privilege of conducting activities within a state, thus invoking the benefits and protections of its laws, thereby submit to the jurisdiction of that state.

We must recognize that individuals or entities effecting transactions through foreign financial institutions on the U.S. securities markets engage in conduct within the U.S. The conduct is a deliberate "invasion" of the territory of the U.S. If secrecy or blocking laws are asserted to cloak the transactions and impede our investigations, then there is an affirmative infringement of U.S. sovereignty and the Commission's mandate to preserve the integrity of our markets.

The U.S. securities laws must apply, and be applied, to anyone engaging in conduct in our capital markets. Those laws must permit the investigation and prosecution of persons in any nation who engage in fraudulent transactions in our securities markets.

Secrecy and Blocking Laws

Now, permit me to discuss the practicalities of the problem.

The Commission investigates a wide range of market activity and corporate disclosure. Normally, where a suspicious transaction occurs, the Commission's enforcement staff requests trading records of the broker and customer involved and takes testimony to determine whether illegal conduct occurred. Similar action is taken when investigating the adequacy of corporate disclosure. Let me give you examples how our efforts are impeded by secrecy or blocking laws.

Secrecy law example -- market fraud hypothetical. Suppose XYZ Corporation plans a tender offer for the shares of ABC Corporation. Furthermore, suppose either an officer of XYZ or one of its professional consultants misappropriates material non-public information concerning the unannounced tender offer, and places a purchase order for the securities of ABC through a bank in a secrecy jurisdiction. If the transaction had been conducted through a U.S. brokerage firm, the Commission could quickly identify the individual involved. However, because the transaction was effected through a bank in a secrecy jurisdiction, the Commission would be denied access to the information necessary to determine whether a securities law violation had occurred.

Blocking law example -- disclosure fraud hypothetical. Next, suppose the Commission is investigating fraudulent financial disclosures of a U.S.-based multinational corporation with a significant subsidiary in a country with blocking laws. The enforcement staff would subpoena the U.S. parent requesting production of the foreign subsidiary's books. If the records were in the U.S., the staff could quickly obtain them. However, if the records were maintained by the subsidiary in a country with blocking laws, the Commission may be impeded from obtaining the same documents it could routinely subpoena from the U.S. offices of the corporation. Typically, the Commission staff is told that it would be a criminal act in the foreign jurisdiction for the corporation's foreign subsidiary to supply the information.

In the market fraud example, the Commission could initiate various diplomatic or litigation steps in an attempt to obtain the identity of the customers or the records involved. If assets remain in the U.S., the Commission might seek a court order freezing those assets. Furthermore, it could elect to file a John Doe complaint even without knowing the identity of the individuals involved and the reasons for their conduct. Thereafter, it might file a motion in federal court to compel the foreign financial institution involved to disclose the names of its customers or to produce the subpoenaed records. Other expensive and time-consuming alternatives also are available. Even after these steps are taken, secrecy and blocking laws can defeat the effort.

These examples dramatize how secrecy and blocking laws jeopardize our enforcement efforts. To pursue either of the investigations would be resource intensive, time-consuming and frustrating. This commitment puts an enormous strain on our limited enforcement resources.

The use of secrecy or blocking laws to avoid detections of violations of U.S. laws has created a *de facto* double standard for enforcement of the securities laws. One standard exists for those located within the U.S., and a lesser standard for those trading within the U.S. but from beyond our borders. As securities laws violators increase their use of intermediaries outside the U.S., the integrity of our markets is threatened. The Commission seeks to eradicate this double standard.

SEC v. Certain Unknown Purchasers of the Common Stock of, and Call Options for the Common Stock of, Santa Fe International Corporation

Litigation initiated by the Commission in October 1981 involved purchases of the common stock of, and call options for the common stock of, Santa Fe International Corporation immediately prior to the public announcement of a merger between

Santa Fe and the Kuwait Petroleum Corporation. Various Swiss banks purchased the securities for their own omnibus accounts, and refused to divulge the names of the principals for whom they engaged in the transactions.

The court issued a temporary restraining order against the unknown defendant purchasers freezing $6.5 million, the profits derived from the transactions. For 20 months, the Commission has been seeking the identities of the unknown purchasers. After lengthy discussions with the defendants' counsel and the government of Switzerland, in March 1982 application was made to the Swiss for assistance pursuant to the 1977 Treaty on Mutual Assistance in Criminal Matters. In January 1983, the Swiss Federal Tribunal denied the requested assistance. The Commission has sought other avenues, short of compulsory measures, to learn the customers' identities. Three of the customers voluntarily disclosed their identities. However, efforts to learn the identities of the other purchasers have failed. An enormous amount of resources has been consumed.

SEC v. Banca della Svizzera
Italiana and Certain Purchasers
of Call Options for the Common
Stock of St. Joe Minerals Corporation

Litigation initiated by the Commission in 1981 involved transactions in the common stock and call options for the common stock of St. Joe Minerals Corporation just prior to the announcement of a takeover bid for that corporation. The case represents the most significant achievement the Commission has had in combating secrecy laws through litigation.

After the bank in that case refused to provide needed information, the Commission made an effort through the Departments of State and Justice and with the Swiss authorities to use non-compulsory means to learn the customers' identities. No such solutions were available. As a result, a motion was made in federal court seeking to compel production of the requested information. The Commission asked the court to compel the foreign bank which transacted purchases on American securities exchanges to make discovery and answer interrogatories concerning its undisclosed principals although the acts of disclosure might subject that party to criminal liability in Switzerland.

In November 1981, Judge Milton Pollack of the U.S. District Court for the Southern District of New York granted the Commission's motion and ordered the bank to disclose its customers' identities or risk substantial sanctions.

Judge Pollack stated,

> "The strength of the United States interest in enforcing its securities laws to insure the integrity of its financial markets cannot seriously be doubted. That interest is being continually thwarted by the use of foreign bank accounts."

He concluded:

> "It would be a travesty of justice to permit a foreign company to invade American markets, violate American laws if they were indeed violated, withdraw profits and resist accountability for itself and its principals for the illegality by claiming their anonymity under foreign law."

The bank then obtained a waiver from its customer, and produced the requested information.

Securities Laws: Protecting a Vital National Interest

The securities laws represent a "vital national interest" of the U.S. Judge Pollack's St. Joe opinion is an important precedent, but the case-by-case method for analyzing whether production of information will be compelled in enforcement litigation does not provide the most effective deterrent against securities laws violators. It was an extraordinary solution for an extraordinary case. If secrecy had not been interposed in the Santa Fe and St. Joe cases, each could have been resolved with one-tenth the amount of Commission resources.

While greater enforcement resources would enhance our efforts, such increases would be band-aid solutions. Effective enforcement requires deterrence. Potential violators must be deterred by the fear that their conduct will be scrutinized if they use secrecy or blocking laws to conceal their identities or business records.

While we do not wish to impede capital formation or the continued internationalization of the U.S. securities markets, investors must be protected. Workable solutions must be sensitive both to the needs of enforcement and to the sovereignty of other nations. The solutions must be found both in the international arena, with agreements among the active trading nations, and domestically with laws which improve our ability to conduct investigations and prosecute enforcement actions.

The Swiss, for example, have shown great interest in devising methods to assist the Commission in fulfilling its mandate. Their efforts in this regard deserve great praise and respect.

1977 U.S.-Switzerland Treaty on Mutual Assistance in Criminal Matters

The Commission staff assisted in the negotiation of the 1977 Treaty on Mutual Assistance in Criminal Matters with Switzerland. This Treaty, one of the first of its kind, has provided some assistance in policing the U.S. securities markets.

1982 Memorandum of Understanding and Private Agreement

In August 1982, the Commission concluded six-months of consultations with the government of Switzerland. A Memorandum of Understanding was executed to supplement the 1977 Treaty.

The MOU provides that, for certain insider trading cases in which information cannot be obtained under the 1977 Treaty, a private agreement among members of the Swiss Bankers' Association who trade on U.S. securities markets would apply. This private agreement provides an alternative method for the handling of requests from the Commission in insider information cases involving a tender offer or other business acquisition.

The U.S.-Swiss MOU represents a landmark agreement. It demonstrates what can be achieved by two nations in the area of mutual law enforcement cooperation. It provides an important vehicle for the Commission when investigating insider trading cases where Swiss accounts have been utilized. Without the Swiss commitment to finding a solution to this problem, our consultations would not have succeeded.

Broader Solutions

The Commission's vitality as an enforcement agency depends on its ability swiftly to investigate suspicious activity in the securities markets or failures to disclose material information. The Commission needs means to attack the problem -- tools to assure its ability to complete investigations and enforce the securities laws against those who use our markets for fraudulent activities.

While the Mutual Assistance Treaty and the MOU between the U.S. and Switzerland provide viable means for combating those who utilize a Swiss account to circumvent the U.S. securities laws, they do not apply to all violations of the securities laws.

There are many other nations with secrecy and blocking laws which offer anonymity to investors with respect to banking and financial transactions. It would be impractical for the Commission to negotiate separate disclosure agreements with each of these jurisdictions. Moreover, the remedy available under Rule 37 of the Federal Rules of Civil Procedure, which was employed in the St. Joe case, can only be applied in cases where the Commission has sufficient evidence to initiate a civil enforcement action in court.

Your staff requested that I pose questions for this Subcommittee to consider during its important deliberations. They asked that I raise issues concerning possible legislation to assist the Commission's enforcement effort. Before I pose questions, I want to point out that they are my own and do not necessarily represent the position of Chairman Shad or the Commissioners, the President, or the Office of Management and Budget. The questions are:

First, does the Commission need legislation that will put all persons on notice, and provide by operation of law, that the act of effecting a securities transaction in the U.S. constitutes a waiver of any secrecy provisions that a person or an agent may waive?

Second, does the Commission need improved means for obtaining the assistance of a U.S. district court, during an investigation, in requesting and obtaining information from persons or institutions located overseas? At the present time, the Commission can use its investigative subpoenas only if a person or entity can be found within the U.S. and must rely, when dealing with persons located abroad, on voluntary cooperation, or, where available, bilateral or multilateral international agreements -- options which are time-consuming and resource intensive.

Third, would it be helpful if legislation were enacted providing that the act of effecting a securities transaction in the U.S. shall constitute the appointment of the U.S. broker-dealer used as an agent for service of process with respect to any Commission enforcement action or any statutory action that might be initiated to assist the Commission in seeking information in the course of its investigations?

Fourth, to further eliminate problems in conducting investigations and prosecuting enforcement actions, should legislation be enacted providing that the act of effecting a securities transaction in the U.S. shall constitute a consent to the jurisdiction of the U.S. courts with respect to any action that might arise out of the transaction?

Since neither the Commission nor the Division of Enforcement has carefully analyzed the cost-effectiveness and relative merits of affirmative answers to these questions, legislation is not recommended at this time. These are areas that warrant further consideration.

Conclusion

Protecting investors and maintaining the integrity of the U.S. capital markets requires vigorous enforcement of the securities laws. This is essential to maintain investor confidence that the marketplace is fair and honest.

With increased foreign transactions taking place in the U.S., we must decide whether the Commission has adequate enforcement tools to protect the American markets.

As it stands now, there are two sets of rules: one for those located within the U.S., and a lesser standard for those trading within the U.S. but from beyond our borders. We must send a clear message to all persons who save and invest in the U.S. securities markets: "We welcome your participation, but you cannot expect preferential treatment. If you want to trade in our markets, you must agree to play by our rules."

PREPARED STATEMENT OF ROBERT B. SERINO

DIRECTOR, ENFORCEMENT AND COMPLIANCE DIVISION
OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
OF THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

May 24, 1983

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to express the views of the Office of the Comptroller of the Currency (OCC) concerning the problems and abuses connected with certain offshore institutions and corporations. The subject is one that bears close scrutiny, and we commend the Subcommittee for its efforts. We look forward to working with you in the future to develop solutions to these problems.

The OCC's jurisdiction is limited to regulation and supervision of approximately 4,600 national banks and their branches or subsidiaries. While we may lack jurisdiction over offshore shell banks and their licensing authorities, we are fully committed to finding solutions to the problems created by such banks because of the danger that these banks pose to the integrity and assets of the banking system.

Certain offshore shell banks have caused serious losses to individuals and financial institutions through fraudulent operations. The crisis, however, is not the size of loss to any one person or bank, as much as it is the volume of such frauds being perpetrated upon a substantial number of victims throughout the world.

I will begin with a brief overview of the nature of the problem. I will then describe the OCC's action to date. Finally, I will recommend further action necessary to combat the problem.

THE PROBLEM

There are two basic aspects of this problem. The first is the offshore financial institutions and corporations that have been used to perpetrate frauds. The second is the proliferation of illegitimate brokers who misrepresent themselves as having multimillions of dollars from offshore sources available for deposit or loans at reduced rates.

Offshore Shell Banks

There are clear distinctions between fraudulent offshore shell banks and offshore bank offices that are operated by legitimate U.S. banks and long-established, large multinational banks. These latter banks are fully capitalized and well staffed, and provide complete commercial and merchant banking services. Further, they maintain actual correspondent bank relationships with other large multinational banks for orderly check payment and clearing processes.

This Office does not have information about the total number of offshore shell bank licenses issued nor do we know about the actual operations of all of the licenses known to exist. We are knowledgeable about certain offshore shell banks that have been used as principal vehicles to perpetrate substantial frauds. These are the institutions that I wish to address today.

The offshore shell bank is just that--a shell; it is a "suitcase" operation." For the most part, there has been no actual capitalization, no actual main office or place of business. There is no actual staff, fixed-asset investment, or the other accoutrements of an actual bank. A license is issued usually upon receipt of relatively nominal fees and minimal background verifications. A local person, usually a solicitor, is required to act as a resident representative. The solicitor then becomes the mail drop and answering service. For the most part, the license does not allow the "bank" to conduct business with the country's residents and local businesses but only "off-island." Attendant with the registration of the license is a list of banking powers which permits the bank to perform a full range of "financial services."

Once an individual bent on perpetrating a fraud is in control of a banking license issued by an offshore jurisdiction, it offers limitless possibilities to his endeavors. An offshore bank license enables an individual to exploit the investigative difficulties and complexities encountered when criminal activities extend beyond the sovereign limits of a single nation. These problems are exacerbated when secrecy laws prevent cooperation of the offshore government.

Operations of Fraudulent Shell Banks. After obtaining the license, the owner/operator sets about to establish "credibility." There are countless ways this is done. The bank may assume a name similar to a major legitimate institution. It may open a checking account in a major bank and represent to the public that the major bank is its "correspondent". It may place an ad in recognized world bank directories or publications.

These shell banks may defraud the public and legitimate banks in several ways, including:

- Solicitation and acceptance of deposits based on promised high rates of return. Although the original customers may, in fact, receive a high rate of return, once the "credibility" is established and a sufficient number have been duped into the Ponsi scheme, the funds are diverted to the owners of the bank.

- Issuance of fraudulent instruments, such as certificates of deposit or letters of credit, that are subsequently pledged as collateral to secure extensions of credit from a legitimate financial institution.

- Issuance of fraudulent instruments to be used as an "asset" in a financial statement of a company closely associated with the fraud perpetrators and as "flash money" in other instances.

- Selling "float time" by the issuance of cashier's checks and other official checks or drafts at a small fraction of the face amount or in exchange for a personal check. This is done with the understanding that when the items are sent through for collection the operators of the bank will delay or confuse the collection process and thereby interfere with identification of a fraud.

- False verification that funds are on deposit in a particular account or that an individual or entity is a "valued customer."

- Issuance of letters of credit to be used as backing by illegitimate brokers who then represent they have access to large sums of money overseas.

The fraudulent offshore shell bank seldom honors any of the obligations drawn against it. Excuses usually given are:

- The obligation was drawn against an account which has been closed.

- A stop-payment order was placed on the obligation.
- The obligation is subject to third-party collateral.
- The obligation has not been received or the obligation is only a copy and payment will be made only against the original.
- The maker of the obligation has defaulted or has been discovered by the "bank" to be an unacceptable customer risk.
- The instrument is not an obligation of the bank because it was fraudulently issued by a "former employee" of the bank without authority.

Individuals are defrauded either by depositing funds in anticipation of a significant return or by accepting an instrument in payment of an obligation. Legitimate financial institutions suffer losses when they permit their customers to draw against uncollected funds or to negotiate transactions with a vendor based upon the backing of a phony letter of credit. Banks may also be defrauded when they make loans secured by phony certificates of deposit and other direct obligations of the shell bank.

Law Enforcement Difficulties. Detection of a fraud is hindered by the delaying tactics and the skills of the shell bank operators in convincing a victim that payment may ultimately be received. It must also be remembered that the paper of the bank is being spread worldwide and by the time a victim steps forward or action is taken to stop the bank, many others have already been hurt. In addition, an individual or financial institution may be slow to lose faith in the legitimacy of a transaction and to overcome the embarrassment of having been taken.

When a particular shell bank is identified as being potentially a subject of concern, the operators may buy time by claiming the bank is legitimate but that one of their "former employees" issued instruments of the bank without authority. The operators may also simply abandon institutions under investigation and obtain new licenses to continue the fraud. For example, over a period of several years, Kevin Barry Krown used at least five shell banks. He was eventually indicted and found guilty in several different jurisdictions. As part of his defense he contended that he did not know that the banks were fraudulent and, once so informed by the OCC's Banking Circulars, he stopped using them.

Some offshore authorities may be uncooperative in providing information concerning the operators of the shell bank and its assets. They may provide the name of the locally appointed representative, who is usually well regarded, but the identity of the controlling owners may not be disclosed. Further, a bank's operators are extremely careful to observe all licensing requirements and not to defraud the people in the locality in which they are licensed.

In addition, some jurisdictions may not cooperate for fear of losing the income that licensing fees provide. Moreover, many have strict bank secrecy laws that limit access to information. We have found that once the cooperation of the authorities in a particular jurisdiction is obtained or the jurisdiction is cracking down on licenses, the swindlers have turned to a new jurisdiction.

The flexibility of such an operation and its mobility throughout the world create significant jurisdictional as well as investigatory burdens for the law enforcement community. These burdens are in addition to the already difficult task created when one seeks to piece together and prosecute a "white-collar crime." Unlike a "street crime" in which the existence of a crime is usually blatant, a "white-collar crime" is, by its nature, complex and purposefully concealed. In order to uncover the fraud and then differentiate between the victims and co-conspirators, investigators must piece together several transactions occurring in several jurisdictions. It is therefore essential for law enforcement agencies that are attacking the problems created by these shell institutions to coordinate their investigations and share information available in different jurisdictions and agencies worldwide.

Brokered Loan Fraud

Although brokered loan frauds have existed for years, the volume of such fraudulent activity has increased substantially in the last decade and has touched the entire spectrum of the banking community. I have attached copies of the Banking Circulars issued by the OCC detailing the problem.

Essentially, a brokered loan fraud involves false representations that multimillions of dollars are available from offshore sources for deposit in a U.S. financial institution or to lend to individuals or businesses at a low rate of interest. At some point, fees or costs are paid by the victim and the funds are never forthcoming.

Operations of Brokered Loan Frauds. Although there are numerous variations to the scheme, an essential element to all such frauds is a positive reaction from a major institution such as a legitimate bank, an insurance company, or a securities firm. Often the process is begun through the use of intermediaries such as local attorneys, CPA's, or other persons well known to the bank who may have been duped into providing credibility to the scheme. It has often been difficult to distinguish between the active participants in the fraud and those who believed they were taking part in an innovative financial transaction.

A borrower/victim is approached by individuals who purport to represent foreign lenders (oil-rich individuals, trust accounts of wealthy foreigners, etc.) who are seeking a safe haven for their money in the United States. The funds, reported to be multimillions/billions of dollars, are offered at a rate well below current market and on exceedingly long terms, usually twenty years.

The name of the source of the funds is not revealed to the victim. The source is said to require anonymity thereby creating the need for the broker. The broker may ask for an advance fee in order to secure the funds, or the borrower may be assured that the broker's commission will be paid at settlement; however, the broker demands funds to cover "expenses" such as travel, site inspection and specification analysis. These so-called expenses frequently exceed $50,000.

The victim may be told that in order to reach settlement, he must obtain a binding commitment from his bank such as a "mandate", "letter of commitment", "bank acceptance", "escrow agreement", or "ICC Note". Using this "evidence" that the so-called broker is engaging in legitimate financial commerce, the broker may cheat other victims out of upfront fees. These latter victims are the primary targets of the brokered funds frauds.

Victims of these schemes include real estate entrepreneurs who are accustomed to paying upfront fees to their legitimate funding sources, persons seeking funds for their business needs and banks who unwittingly become involved based on the assurance that there are no upfront fees or commissions until settlement. We have seen instances where bankers have released bank documents with the belief that they have no actual liability until the brokered funds are received. This has not prevented threats of lawsuits against banks for the credibility they brought to the scheme or for the "damages" they caused when they "backed out of the deal."

THE OCC'S INVOLVEMENT

Over the past several years we have noticed a rapid increase in the creation of shell banks and brokered loan frauds and have identified a significant number which have been involved in fraudulent operations. For that reason, in late 1978, we directly contacted several offshore jurisdictions to seek their cooperation. We expressed our concern over the apparent increase in the use of offshore banks in schemes to defraud. We requested that the jurisdictions, principally in the Caribbean, cooperate with our efforts and establish direct communication with us in order to:

* Exchange information concerning banking statutes and regulations;

* Provide current lists of registered banks and notification of terminated licenses; and

* Respond to inquiries concerning institutions which had come to our attention.

Information developed from offshore authorities, law enforcement agencies, financial institutions, and individuals is obtained by our Enforcement and Compliance Division. When we have obtained sufficient information indicating potentially fraudulent activity, we issue Banking Circulars. The Circulars advise caution in dealing with participants, normally shell banks, and request information on transactions with them. These Circulars have helped alert the industry to potential problems. In many instances, they have generated additional information about other transactions in different jurisdictions which confirmed the existence of a true fraud.

Partly as a result of our notices and our frequent direct inquiries, several jurisdictions have become concerned about their reputations for being havens for "phony banks." One jurisdiction, in fact, placed a moratorium on the issuance of licenses and reduced its outstanding licenses from approximately 200 to 20. New laws in this jurisdiction also required thorough investigations of applicants for licenses and established stringent capital requirements and criminal penalties for obtaining a license by fraud. Unfortunately, when the laws were tightened, the licensing activity moved elsewhere.

Information obtained by the Comptroller's Office is made available to the law enforcement community through referrals of potentially fraudulent activity and responses to daily inquiries from Federal and state law enforcement authorities. We are also able to provide the identity of other law enforcement authorities that are investigating the same bank or individual. This coordination of sources of information is absolutely essential in putting together prosecutable cases involving shell banks.

We believe that cooperative efforts of the law enforcement and banking communities have resulted in substantial progress toward a solution to the problem. We look forward to additional successes as we focus on new solutions.

SOLUTIONS

Several steps can be taken to make it more difficult to misuse a bank license.

Coordination and Communication

Improved communication between law enforcement authorities on both a domestic and international basis is essential for the prompt discovery and successful prosecution of offshore shell bank or brokered funds frauds. Where several jurisdictions are investigating similar transactions, it may be appropriate for a central source to coordinate the investigation and determine which jurisdiction would be most appropriate for initiating prosecution.

In the U.S., the need for information sharing among Federal law enforcement authorities has been recognized and working groups have been established to work toward that objective. The possible use of the Treasury Department's Financial Law Enforcement Center's (FLEC) computer system is currently being explored.

On the international front, I recently had the privilege of participating as a member of the working group on ecomonic crime sponsored by INTERPOL's American Region along with representatives of Treasury, IRS, Postal Service, Customs, DEA, FBI, INTERPOL's Washington National Central Bureau, and several nations. The major item on the agenda was the use of shell banks in criminal activities. The discussion focused on the need for coordination and cooperation not only in narcotics investigations but also in investigations relative to shell banks. Several recommendations were made to the General Secretariat of INTERPOL which would, among other things, encourage the member countries of INTERPOL to aid in establishing a data base that can be used in coordinating investigations. The system of communications established by INTERPOL, coupled with the willingness of the member nations to supply information, will greatly assist in the identification, investigation, and prosecution of fraudulent operations in a more timely manner.

Restraints on Information Sharing Should be Reviewed

The various privacy restraints such as the Right to Financial Privacy Act of 1978, the Privacy Act of 1974, the Grand Jury Secrecy Rule, and the Tax Reform Act of 1976 were all enacted for legitimate reasons. However, their effect, either actual or perceived, is to somewhat impede the free flow of information among agencies. All of the agencies and the earlier staff studies of this Subcommittee highlight a major need to review justifications for such constraints.

Improving Banking Legislation in Offshore Jurisdictions

The most direct way to deal with offshore shell bank frauds is for offshore jurisdictions to enact legislation that would make it more difficult for fraudulent operators to obtain a bank license. Some jurisdictions have adopted such legislation which covers the following points:

- Effective bank regulation and supervision to identify shell bank frauds;

- Disclosure of information for law enforcement purposes;

- Evaluation and approval of actual owners, both in licensing and subsequent changes in ownership;

- Requirement of actual payment and verification of sufficient capital, before granting a license, in an amount that would discourage applicants bent on fraud;

- Required annual disclosure of financial condition prepared and certified by a recognized firm;

- Clear penalties for violations.

The INTERPOL conference recommendations also addressed the need for such legislation.

Elimination of Secrecy Protection for Banks Being Used for Criminal Purposes

Another potential remedy to address the fraud problem is the removal of bank secrecy protection for banks which are being used to perpetrate fraud. In turn, formal procedures must be established by which the law enforcement community can obtain information relative to these banks. The type of information available and the method by which it may be obtained must be made known at the international level. The INTERPOL conference recommendations also address this issue.

Bank Fraud Statute

Often, the investigations and prosecutions of cases involving offshore shell banks or money brokers are extraordinarily complicated. Pending legislation submitted by the Administration would facilitate prosecution of shell bank cases and would eliminate some of the jurisdictional difficulties that have been created where prosecutions have been brought for frauds perpetrated on U.S. banks.

CONCLUSION

I would like to thank the Subcommittee for giving me the opportunity to present the views of the OCC here today. Additional public information about the abuses connected with offshore shell banks will increase the caution exercised by legitimate financial institutions and the public when dealing with these fraudulent entities. We also hope that increased international scrutiny will convince offshore jurisdictions of the problems created by indiscriminate licensing of offshore banks. Finally, we look forward to a continuation of current efforts to enhance cooperation within the law enforcement community.

BC - 141
SUPPLEMENT 2

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular   Subject: Brokered Funds

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Regional Administrators; Examining Personnel

This issuance is the second supplement to Banking Circular #141 dated May 2, 1980, which highlighted some of the hazards faced by banks becoming involved in abnormal money-brokered transactions. This Office continues to receive information about proposed large money fundings to be placed through United States banks with the source of such placements being a foreign entity lender not otherwise identified. Some banks have attempted to assist customers who represent themselves as borrowers and/or brokers in such endeavors. The involvement of a United States bank appears necessary to provide credibility to the proposed financial transaction.

In recent months, it has been brought to our attention that certain brokers have been circulating letters of this Office which purportedly give their proposals credibility. You are advised that at no time has this Office encouraged, approved, or in any manner supported the furtherance of any such financial transaction involving multimillions of dollars originating from undisclosed foreign lenders and which reflects terms and rates far more favorable to the borrower than can be obtained from normal market sources. Any such representations citing this Office as being in support of such brokered funds transactions should be disregarded.

Extreme caution is suggested in evaluating these transactions. It is suggested that each bank establish a central contact for these types of offers and should bring them to the attention of:

Robert B. Serino, Director
Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

C. T. Conover
C.T. Conover
Comptroller of the Currency

Date. July 14, 1982   Page 1 of 1

BC - 141
SUPPLEMENT 1

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Brokered Funds

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Regional Administrators; Examining Personnel

This Office has issued banking notices over the years which cite the hazards involved relative to negotiations with persons who purport to have access to multimillions of dollars for placement in the United States. Banking Circular #141, dated May 2, 1980, cautioned the financial community about this problem. Inquiries about the propriety of such proposed transactions have increased substantially.

Recent solicitations from "brokers" contain the same basic elements as in the past. Banks and their trust departments have been requested to act in either a fiduciary capacity or as an escrow agent to receive large placement funds from unidentified sources, many of which purport to originate outside of the United States. The purpose of many is to generate responses reflecting credibility of a transaction or entity. Rates and terms are quoted which are considerably more favorable than for funds obtainable from normal sources.

Frequently, written responses are requested on a suggested format to be placed on official bank stationery or in the bank's telex messages. Some solicitation packages include documents to be signed committing the recipient either to pay upfront fees or to fund commissions through "emissions." Some United States banks have advised that their banks have been named in solicitations without their knowledge or authorization.

Date October 9, 1981

BC - 141
SUPPLEMENT 1

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type: Banking Circular

Subject: Brokered Funds

In every known instance brought to the attention of the Enforcement and Compliance Division of this Office to date, there has been no evidence that an assured source of funds is available as indicated by those promoting such disbursements. While it is recognized that some intermediary brokers may be innocent of any inappropriate activity, banks are advised to view any solicitation with extreme caution and to report any questionable contacts to:

Robert B. Serino, Director
Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

Paul M. Homan

Paul M. Homan
Acting Comptroller of the Currency

Date: October [illegible], 1981

BC - 141

BANKING ISSUANCE

Comptroller of the Currency
Administrator of National Banks

Type Banking Circular

Subject Brokered Funds

TO: Chief Executive Officers of National Banks; all State Banking Authorities; Chairman, Board of Governors of the Federal Reserve System; Chairman, Federal Deposit Insurance Corporation; Conference of State Bank Supervisors; Regional Administrators; Examining Personnel

This Office has been advised on numerous occasions of widespread solicitation by persons who purportedly have access to multimillions of dollars readily available for loans and deposits in United States financial institutions. Rates and terms quoted, for the most part, are more favorable than for funds obtainable from normal sources. This Office has reason to believe that many such solicitations are not backed by any assured source of funds and that such contacts are for the purpose of involving a financial institution in an "advance fee scheme" either as a victim or to give credibility to the perpetrators. In some instances, solicitations cite that "the program is sanctioned by the State Department and the Federal Home Loan Bank." We have been advised that no such authorizations have been obtained. In such schemes, the "broker" promises large amounts of monies from unidentified sources which, in many cases, are purportedly located in foreign countries.

Banks may be requested to pay "upfront fees." Banks may likewise become involved by acknowledging solicitations in writing or by telex messages or by sending letters on bank stationery. The solicitors may use such responses to give credence to their operations in order to obtain an "upfront fee" from someone else.

It is recognized that some such brokers may be innocent of any such inappropriate activities; nevertheless, banks are advised to view all solicitations with extreme caution. Any questionable contacts should be reported to:

Robert B. Serino, Director
Enforcement and Compliance Division
Office of the Comptroller of the Currency
Washington, D.C. 20219

John G. Heimann
Comptroller of the Currency

Date May 2, 1980

Page 1 of 1

PREPARED STAFF STATEMENT

OF THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

MAY 24, 1983

The Permanent Subcommittee on Investigations has uncovered an extensive use of offshore banks, trusts and corporations by U.S. citizens and residents. While it had been generally assumed that this use was the exclusive playground of the elite who could afford special counsel to create and advise on the use of these structures, the information compiled by the Subcommittee clearly shows this is no longer the case. Today, a new breed of entrepreneur peddles these foreign banks (as well as trusts and corporations), to the public at large, appealing to clients' desires for wealth and power.

These bank brokers of the '80s establish their base of operations in a foreign country, typically a small island nation, which permits the establishment of financial institutions with few restrictions but with strict secrecy laws. The brokers then acquire a resident agent and purchase licenses from the government for the establishment of Class B, offshore, or "brass plate" banks, so called because they consist of little more than a file in a resident agent's drawer and a door plate trumpeting their existence. This type of bank is permitted to do business with non-residents, i.e., offshore business. Once these licenses are obtained, the broker will market his banks using methods from a sophisticated marketing network to a simple advertisement in the classified section of a newspaper.

The sales pitch for an offshore bank usually takes one of two forms. First, the prospective client is told of the many ways in which a bank can be profitable. For example, it can attract flight capital from rich South Americans and Europeans who are trying to find a place to put vast amounts of money thus making the client a powerful figure in international finance instantly. Second, the prospective client is told that banking, currency and securities laws in the United States have all but destroyed the type of individual capitalism upon which this country was founded and that one way to restore this greatness is to throw off "the yoke of regulations" and use the freedom and secrecy which only offshore banks permit.

The Subcommittee has shown, in its March 1983 hearing and the accompanying staff study, that there is a substantial use by criminal elements of offshore financial institutions and secrecy laws. In the course of its work, the Subcommittee discovered that offshore banks and corporations are actually marketed to U.S. citizens through seminars, newspaper and magazine advertisements. The Subcommittee scrutinized the WFI Corporation as well as some smaller brokers in order to present an overview of offshore bank brokers.

WFI Corporation

WFI Corporation of Los Angeles was incorporated in March of 1975 with Jerome Schneider as principal owner and president, Robert Buchsbaum as executive director and January Mills as secretary and controller. WFI President Schneider describes himself as having been a financial consultant in the early 1970's who became interested in offshore banking when his clients requested information on establishing banks outside the United States. A list of known WFI banks is attached in the Appendix.

In 1975, Schneider used WFI to establish corporations in the Cayman Islands for resale to clients interested in that island's tax and secrecy laws. WFI branched out from 1976 to 1979 by selling bank licenses in St. Vincent and Anguilla. According to Schneider, a bank was sold by WFI every other month during that three year period. These banks could be purchased by WFI for less than $10,000 and were resold to WFI clients for as much as $37,000 each.

In 1979, Schneider obtained the name of David Brandt, a Montserrat attorney, from the Registrar of Montserrat Companies. WFI then entered into an exclusive relationship with Brandt, under which Brandt would act as WFI's agent to obtain bank licenses in Montserrat. On January 4, 1980, WFI established its first licensed bank in Montserrat. Since that time WFI claims to have licensed 50 banks in Montserrat.

Montserratian officials told PSI that they had little or no information as to how these banks were used. These officials expressed concern that the banks could be used for criminal purposes. They further informed PSI that brokerage of offshore bank licenses would no longer be permitted. Accordingly, WFI moved its operations to the Pacific, placing clients in banks in the Republic of Vanuatu (formerly the New Hebrides) in 1981.

As WFI sold more licenses, the company branched out into other areas to attract interest. WFI conducted "International Conferences on Offshore Banking" in various cities throughout the United States. Prospective clients paid several hundred dollars to hear Schneider and other speakers tout offshore banking in general, and WFI in particular. Attendees received numbered tags rather than name tags. Video tapes of these conferences were offered for sale. A WFI newsletter, "The Offshore Moneyline", offered advice on the tax cutting uses of offshore banks. The WFI publishing company offered "tax haven" and "financial privacy" books, including How to Profit and Avoid Taxes by Organizing Your Own Private International Bank in St. Vincent by Jerome Schneider.*

In January 1982, Schneider traveled to several Pacific islands to talk with government officials concerning the expansion of WFI's activities in these islands. The areas visited included Palau, the Marshall Islands, and the Northern Mariana Islands. (The Northern Mariana Islands, Palau and the Marshall Islands are part of the United Nations Trust Territory of the Pacific which is administered by the United States.)

In an interview with PSI staff, Schneider stated that he chose the Commonwealth of the Northern Mariana Islands (CNMI) as his principle Pacific location because of its close ties with the United States and because the government of the CNMI responded well to his proposals to encourage offshore "brass plate" banks. In March 1982, Emergency Rules and Regulations for Licensing of Offshore Banking Corporations were issued by the government of the Marianas. According to Mr. Schneider, these rules and regulations were encouraged by him in order to provide adequate supervision of offshore banks. The regulations provided for capitalization of an offshore bank with $10,000 cash, did not require the owners or operators of an offshore bank to have prior banking experience, and provided a certain level of secrecy for the banks' operations and transactions.

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*In 1980, the Los Angeles District Attorney filed suit in California state court against WFI and Schneider, charging they had not furnished substantiation required by law for advertisements for the book. The Superior Court of California enjoined WFI and Schneider from advertising any facts or "making any representation" for any product or service which "could not be substantiated by factual, objective or clinical evidence."

In an August 1982 publication, WFI cites the Emergency Regulations in labeling the Marianas as "...one of the best locations in the world to own an offshore bank." WFI touts the secrecy of offshore banking in the CNMI by quoting the regulations: "No information provided in compliance with these regulations shall be furnished to any third party..." Significantly, WFI stops quoting at this point when in fact the regulations state in full: "...except upon court order, subpoena, other judicial process or the express consent of the parties involved."

In an "Offshore Bank Offering Memorandum" distributed in 1982 and in a September 16, 1982 "Status Report", WFI claims that neither the banking nor the securities laws of the United States apply to the Northern Mariana Islands. Circumvention of these regulations is offered by WFI to prospective clients as an advantage to owning an offshore bank in the Northern Marianas. These claims have been adamently refuted by both United States and CNMI government officials with whom PSI spoke.* The CNMI House of Representatives has subsequently passed a bill raising the licensing fee of offshore banks to $50,000. The ensuing controversy has not yet been resolved by the CNMI Government. CNMI Government officials admit that they are inexperienced and ill-equiped to deal with the complex issues involved with offshore banking.

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* Mr. Daniel MacMeekin, Executive Director of the Northern Mariana Islands Commission on Federal Laws, told PSI staff that, in his opinion, the banking and securities laws of the United States, with few exceptions, do apply to the Northern Mariana Islands.

Following implementation of the March 1982 Emergency Regulations, WFI obtained 50 offshore bank licenses in the CNMI. Since that time, WFI has sold 38 of the licenses to third parties with pricing ranging from $20,000 - $35,000. On May 12, 1983 the Speaker of the House of Representatives of the CNMI told PSI that the CNMI government issued new Emergency Regulations governing offshore banking which raised the capitalization requirements to $250,000. These new regulations may restrict the establishment of additional offshore banks and the renewal of licenses of those already in existence. In fact, according to Marianas officials, as of May 12, 1983, none of the 38 WFI brokered banks had renewed thier licenses. PSI has learned that during the last year 16 retail or class A bank licenses have been granted to certain parties in the CNMI for potential resale to third parties. Considering the size of the Mariana Islands (population approximately 17,000) this appears to be a rather large number of banking facilities.

In addition to the Northern Mariana Islands, the governments of Palau and the Marshall Islands have recently taken steps to encourage offshore banking in their countries. Palau proposed legislation governing offshore banking which included strict bank secrecy laws. The secrecy portion of the legislation was suspended by the Trust Territory High Commissioner (U. S. government appointee). The Marshall Islands also proposed offshore banking legislation, but at the suggestion of U. S. officials it has delayed final action. These events, as well as the new regulations issued by the CNMI, reflect concerns over the spread of offshore banking to these Pacific islands.

WFI contracted with a private firm to conduct background checks on prospective clients and apparently continues to run such checks on its own. WFI claims, in a promotional brochure, that it established offshore banks "within strict legal guidelines and following the most careful screening of applicants." There is, however, no indication that an individual purchasing a license will be the beneficial owner. In fact, the contrary is often true. PSI staff has found several cases where the WFI-listed owner was an agent or attorney used by a principal to purchase the bank. In most of these cases the agent was contacted and told PSI that he had no idea how the bank had been used, if it had been used at all. Hence, background checks might not detect even the most notorious criminal purchasing a bank through an agent or attorney. Additionally, the resale of a WFI bank easily circumvents this screening mechanism.

In "Offshore Banking Offering Memorandum," WFI claims "Offshore banking enables customers to maintain accounts in complete confidentiality and privacy and without the burden of being subjected to disclosure by U. S. regulatory agencies. Loans can be made at any interest rate." To facilitate use of the banks, WFI provides customers with a resident agent as well as a large box of pre-printed bank charters, minutes of incorporator's meetings and other documentation which may be used to lend credence to the bank.

WFI has also provided "blank share certificates" and complete banking forms, including letters of credit, international certificates of deposit, and promissory notes. The bank owner is therefore able to immediately place into the flow of commerce a negotiable instrument that has no financial backing whatsoever. Although this practice may result in the revocation of a bank's charter, there are cases where worthless documents issued by offshore Class "B" banks have been negotiated or used as collateral for loans. According to the Montserrat Minister of Finance, the Class "A" banks in Montserrat refuse to allow WFI chartered banks to even open an account for fear of such worthless documents. WFI, in its client survey, admits that "50% of the clients are unable to establish correspondent banking agreements in Montserrat" with two Class "A" banks.

How Are WFI Banks Being Used?

WFI claims to have sold over 150 banks. After exhaustive efforts PSI was able to find only two WFI clients who claim to have legitimately used their banks. PSI staff interviewed Mr. Schneider and examined WFI's client files pursuant to subpoena. Schneider provided PSI with a survey completed December 10, 1981 that allegedly "identifies some of the beneficial uses our clients have with their offshore banks." Although WFI purports to have sold over 150 banks this survey is based on contacts with only 16 WFI clients. WFI lists these clients uses of the banks as follows:

94% - Investment

63% - Account deposits

56% - Loan activities

25% - Trust activities

19% - Eurodollar market

6% - Overseas manufacturing

PSI could account for only 77 banks of the 150 banks claimed by WFI. These 77 banks were owned by 60 different clients while WFI was the owner of record of the remaining banks. PSI staff attempted to contact the 60 owners of record, but met with only limited success. Of these 60 owners, 29 could not be located in the city listed on their WFI application or they declined to be interviewed by PSI. Despite exhaustive attempts, PSI was unable to speak with these 29 bank owners.

PSI staff was able to locate and speak with the 31 remaining owners, 12 of whom were by that time former owners. Six of these former owners claimed never to have been able to use their banks. All six felt that they followed WFI's instructions but were unable to utilize these "brass plate" banks as they expected. For example, they were unable to open accounts in their bank's name at local island banks. They could not, without a great deal of additional resources, engage in the international trading or speculating which WFI had touted.

Three other former WFI bank owners felt that they may have been able to operate a bank successfully but that economic conditions precluded them from putting in the amounts of money that would have been needed to make a bank work. Two other former owners each bought banks for the company in which they were employed. Each then left their respective companies. With no one to look after the banks, the licenses were allowed to lapse. The remaining former bank owner claims to have been duped into opening a branch office for a fraudulent securities scheme operated by another WFI bank owner whom PSI staff was unable to locate. The most recent information indicates that the fraud operator may now be involved with another criminal scheme in the Caribbean. Two of the former owners mentioned above attempted to recoup their losses by reselling their banks. In both cases the banks were resold to unknown persons who were simply able to meet the purchase prices. Obviously, this type of resale circumvents any screening or other protections a broker may establish.

PSI staff also contacted 19 individuals who stated that they were current owners of WFI chartered banks. Eight of the 19 said they have been unable to use their banks for the purpose they intended when purchased. More than half of those unable to use their banks said they felt that WFI had been misleading in its promotion of offshore banks. Six other current owners admitted that they had purchased a WFI bank but would not discuss its use. Most made passing reference to the tax advantages of having an offshore bank. One is a known tax protestor and another said he did not wish to speak to us due to his pending indictment for preparing fraudulent trust tax returns.

Two other current owners were agents for a principal whose name they would not divulge. Neither seemed to have any idea of how the principals were using the banks, nor did they express concern. (Both, however, indicated that their experience with WFI had not been good and that if they had to find an offshore bank they could now do it less expensively and more efficiently than WFI.)

Of the remaining three current owners, one is Ed Harris who purchased a bank to attract foreign investors and then decided to resell. (Harris is discussed in a later section on other bank brokers and salesmen.)

The last two current owners contacted by PSI are the only ones who claim to have actually used their banks. One owner is a Lebanese national who purchased a WFI bank to provide for anonymity of his investments due to the lack of political stability in Lebanon. What these investments were and how they were made was not divulged. The other owner is the president of a California company which trades foreign currency. This individual has used his WFI bank but now feels that he must obtain a bank with more services than his WFI bank can offer. He also stated that only large concerns can actually use an offshore bank for legitimate purposes.

In a 1981 sales brochure WFI lists 12 WFI established banks as evidence of its success. Of the 12, PSI found: no WFI records of 2, allegations of WFI misleading the owners of 2, phony checks passed by 1, and another used in a securities fraud case.

Other Brokers and Salesmen

WFI is by no means the only bank broker. PSI discovered other individuals who use plans of varied sophistication to offer offshore banks, trusts and corporations. The most rudimentary offerings usually involve individuals who themselves have purchased an offshore bank or corporation but have been unable to take advantage of their ownership. In an effort to recoup at least part of their loss, they will attempt to resell the bank or corporation to someone else.

One such individual is Edward A. Harris who owns a construction firm in Zephyr, Nevada. Mr. Harris readily agreed to cooperate with the Subcommittee.

In 1980, he purchased from WFI the American Overseas Bank in Montserrat for $33,500 based on WFI contentions that the offshore bank could be used to raise foreign venture capital.

Harris received a large container of stationery and forms for his bank from WFI. Harris then attempted to contact David Brandt, the WFI agent in Montserrat. Brandt would not answer Harris' letter nor would he send Harris a receipt for license fees Harris paid.

Realizing he was stuck with a bank he could not use for what he planned, Harris then advertised in the Asian issue of the Wall Street Journal to sell his bank. Harris stated that 12 people responded and "virtually everyone sounded like a crook." Harris suspects one person who contacted him went to Montserrat and made a separate deal with David Brandt. Another person ended up swindling Harris out of $2,500 in an advanced fee scheme. Although he attempted to use his bank legitimately, Harris stated that he has been unable to do so or to find any "honest" person interested in buying his bank.

The Subcommittee staff then located and interviewed Robert Harvey and Gordon Noval, who themselves had offered offshore banks for sale. Robert Harvey met with WFI and other brokers before deciding to go to Anguilla and purchase a bank on his own. Harvey and Noval purchased Interbank, Ltd., as the first step to establishing a consortium of offshore banks to participate in an organization designed to ensure legitimate dealings and promote the respectability of member banks.

Interbank, Ltd., was offered for sale in a one day advertisement placed in the Wall Street Journal. From this one ad, Harvey and Gordon Noval stated they were contacted by approximately 95 different individuals in one week. Most of these individuals were looking solely for privacy and lost interest when told that the bank would be audited. Five inquiries were selected as being serious and legitimate, and promotional literature was sent out by Interbank.

Noval and Harvey told PSI investigators that the actual cost of establishing an offshore bank was $9,000. They therefore offered an offshore bank for $21,000, which they considered a reasonable mark-up. WFI and other brokers sell their banks for as much as $50,000. Despite their price advantage, Harvey and Noval were unable to find a buyer for their bank.

PSI investigators also looked at Charles Cranford of Amarillo, Texas, and his International Tax Planning Incorporated. In a November 17, 1982 letter, Cranford offered to "resell an Anguilla Bank for $15,000 which had originally been purchased for $43,000." Cranford claims in this letter to have "received 13 banks in 1982. Cranford also claims that "(i)n the near future we will be selling Costa Rica banks for $25,000."

In an undated cover letter to his offering memorandum, Cranford states:

> "The correct use of the offshore bank will enable its parent owner(s) to legally escape lending limitations, reserve requirements, investment requirements, transaction reporting requirements, regulations and public disclosure transaction."

Yet, in order to facilitate these uses Cranford claims that "no special banking expertise or knowledge is required in order to operate an offshore bank."

PSI staff found that most of the other information offered by both Cranford and Harvey consisted of WFI's offering memorandum with any references to WFI deleted and either "International Tax Planning" or "Interbank" merely substituted. Neither Cranford nor Harvey were concerned that the claims made by WFI as to case histories, services offered or applicable laws may have been totally inaccurate with respect to International Tax Planning and Interbank. Both Cranford and Harvey freely admitted to the use of WFI's offering memorandum and rationalized any misrepresentation in light of their need to provide their clients with some sort of information.

In 1980, Cranford was operating Lloyds of London Insurance and Trust Company, Ltd., in the Turks and Caicos Islands. Cranford was also selling corporations and operating the Church of Human Rights in the Turks and Caicos. In fact, Cranford designated himself "Archbishop Charles H.I." and dedicated his Church of Human Rights "to preserving the moral principles of individual rights and personal property." When questioned by PSI staff, however, Cranford claimed that the church was not a front for tax protesters and, in fact, was never used.

Cranford told PSI staff that he had operated in Anguilla since 1980. Cranford stated that on one trip he was introduced by a local attorney to the Chief Minister of Finance of Anguilla. Cranford claims to have lobbied this minister to promote less restrictive banking laws and deems himself personally responsible for passage of the Anguillan Secrecy Act. Cranford then became licensed to form and sell

Anguillan banks and corporations. Cranford also claimed that he is familiar with politicians in Costa Rica who are "conducive to a certain type of banking," i.e., banking with few restrictions.

Cranford admitted that individuals who buy one of these offshore banks usually lets the license lapse since the banks are simply not usable for any legitimate purpose. In fact, Cranford stated that he does not know of any bank purchaser who was ever able to use one of these banks. Cranford says he simply sells the banks - he has no responsibility to ensure that the bank is ever used for a legitimate purpose.

PSI investigators also spoke with Bill Burke, a project engineer for a contracting firm in Los Angeles. Burke stated that he had traveled extensively in the Pacific and during his travels he became acquainted with high ranking officials in the Cook Islands, including its Premier, Thomas Davis. Offshore banking was apparently of interest to Burke and he attempted to advise Cook Island officials on their developing banking laws. Burke claimed that he was attempting to develop a banking system by which he and the Cook Islands could profit while not conflicting with the U.S. Internal Revenue Code. He stated that he had several million dollars in investors money lined up to purchase a bank, but was hampered by the fact that Cook Island officials were constantly changing the capitalization requirments. Burke has since discontinued efforts to establish a bank in the Cook Islands but remains interested in attempting to create a bank elsewhere.

Based upon PSI's extensive interviews with senior U.S. banking officials, international tax attorneys, senior Administration officials and offshore bankers, we feel we can conclude that at its best, the ownership of an offshore bank may allow an individual to achieve some undetermined competitive advantage. More likely, however is that a prospective bank owner will find the advantages promised by the bank brokers will never be realized. The problem is not merely that gullible or greedy individuals lose thousands of dollars. Offshore banks have also been documented as a crucial aspect of such criminal conduct as tax evasion, secretion of assets in fraud schemes, and money laundering. The possible benefits of these brass plate banks may be outweighed by the criminal abuses of foreign banks which offer strict secrecy, little screening and easy transfer of ownership. Even the host countries themselves may be defrauded as indicated in the following case study.

A Case Study of An Offshore Bank Purchaser

On September 20, 1982, Subcommittee staff members met with J. Paul Smoot, whom WFI records indicated was the owner of record of the City International Bank in Montserrat. Smoot indicated to the Subcommittee that he had been sent two letters by WFI when he requested a WFI publication. Both of these letters were on Co-Op Investment Bankers of Washington, D.C. letter-head, addressed to Jerome Schneider, and signed by A. V. Laurins. Co-Op Investment Bankers is a limited partnership set up by Charlene Baden and Aleksandrs V. Laurins licensed as a mortgage broker by the State of Maryland, Department of Banking.

The first letter, dated March 21, 1979, claims that Co-Op Investment Bankers (here after referred to as Co-Op/Maryland) obtained a banking license in St. Vincent for their affiliate, Co-Op Investment Bank, Ltd., (here after referred to Co-Op/St. Vincent) with the assistance of WFI. The second letter, dated June 27, 1979 states that between January and June of 1979 the Co-Op/St. Vincent netted $150,000 in tax free fees and that $1 million in banking fees were anticipated by the end of the year. PSI decided to contact Mr. Laurins of the Co-Op banks.

The Co-Op/Maryland letterhead listed their address as Connecticut Avenue in Washington, D.C., and listed a local telephone number. PSI staff called the number repeatedly and, although the receptionist acknowledged that the call had reached Co-Op/Maryland, PSI staff was always told that Mr. A. V. Laurins was not in. Messages were left for Mr. Laurins to call the Subcommittee and we were assured by the receptionist that the calls would be returned. They were not. On December 8, 1982, PSI again called and asked to speak to whomever was in charge of the office. A woman identifying herself as Charlene Baden came on the line and said that Laurins was no longer with Co-Op/Maryland.

Ms. Baden said that Co-Op/Maryland was in no way affiliated with Co-Op/St. Vincent. Baden stated that Co-Op/Maryland had moved from Connecticut Avenue but she refused to give a new address. A call to directory assistance easily provided the new address as Suite 309, 11820 Parklawn Drive, Rockville, Maryland.

On December 10, 1982, PSI staff again called Ms. Baden who identified herself as President of Co-Op/Maryland. Ms. Baden stated that she knew Co-Op/St. Vincent existed and that she knew of its operation, but that Co-Op/Maryland had nothing to do with the St. Vincent bank. She then stated that she did not own the bank, that she did not run it and that she had nothing to say beyond what she had already said. Ms. Baden suggested that PSI call Mr. Laurins, and hung up.

PSI staff members placed several calls to Mr. Laurins in San Francisco, California and one call was finally returned on December 17, 1982. Laurins stated that neither he nor Co-Op/Maryland owned the St. Vincent bank and that he would refuse to answer any questions about the proper ownership of the bank. He stated that he was managing director of Co-Op/St. Vincent and the Co-Op International Bank of Anguilla (here after referred to as Co-Op/Anguilla) but, as attorney for both banks, he would refuse to testify concerning either bank under the attorney/client privilege as well as under the secrecy laws of St. Vincent and Anguilla. Mr. Laurins told PSI that any further communications would result in his billing the Subcommittee as a consultant at $350.00 per hour.

The Subcommittee was interested in the purported use of Co-Op's offshore banks but no party concerned would speak to the Subcommittee. It was discovered that both the St. Vincent and Anguilla banks had accounts with the National Savings and Trust (NS&T) Bank in Washington, D.C. These records were subpoenaed by the Subcommittee. Upon a Subcommittee request, WFI also provided information concerning the formation of the two banks.

Signature cards from the NS&T Bank of Washington, D.C., show an account opened with that bank on November 17, 1978 for Co-Op/St. Vincent. Mr. Aleksandrs V. Laurins is listed as President and Treasurer while Ms. Charlene Baden is listed as Vice President and Secretary. Another account signature card for Co-Op/Anguilla is signed by Mr. Laurins as "President" and Ms. Baden as "Ass't. Sec." This account was opened on August 31, 1979.*

WFI records include a copy of a letter from Rene' Baptiste, the Manager/Secretary of the St. Vincent Trust Authority Limited sent to Mr. Alex Laurins on January 24, 1979, with copies sent to Jerry Schneider. This letter informs Laurins that Co-Op/St. Vincent has complied with St. Vincent laws and is eligible to commence business "as of 1st December, 1978." An accompanying letter to Jerome Schneider from Ms. Baptiste, with copies sent to Laurins, releases Schneider from "any responsibility for Co-Op Investment Bank Limited (Co-Op/St. Vincent) as of 1st December, 1978." Also in the WFI material is a copy of the same Laurins to Schneider June 27, 1979 letter that PSI staff members obtained from Mr. Smoot. This letter signed by A. V. Laurins, refers to "our newly formed affiliate, Co-Op Investment Bank in St. Vincent," and thanks Schneider for "putting us into the private, offshore and international banking business."

In an August 10, 1979 application for a banking license from Anguilla for Co-Op/Anguilla, Jerome Schneider, the "attorney-in-fact," lists A.V. Laurins as the Managing Director of Co-Op/St. Vincent and Co-Op/Maryland.

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*NS&T records also show a Resolution-Authorization for Organization Account signed by Charlene Baden for Co-Op/St. Vincent on November 15, 1978 which authorizes herself and Laurins to draw on the account and states that on November 14, 1978 the Board of Directors of Co-Op Investment Bank (St. Vincent) elected Aleksandrs V. Laurins President and Treasurer and Charlene Baden Vice President and Secretary. A similar resolution dated August 27, 1979, shows that Laurins as President and Baden as Assistant Secretary are given control over the Co-Op/Anguilla account at NS&T.

It appears then that Aleksandrs V. Laurins and Charlene Baden were very much involved in, if not directly responsible for, the establishment and initial operation of Co-Op/St. Vincent and Co-Op/Anguilla.

At an April 14, 1983 private deposition in Maryland Ms. Baden admitted to signing checks and sending telexes on behalf of Co-Op/St. Vincent. Although Ms. Baden claims to have resigned from the bank in 1980, she stated that she has retained checks for Co-Op/St. Vincent accounts with NS&T which she will draft and endorse if Laurins directs her to do so. Baden has also signed checks from the Co-Op/St. Vincent account with Dreyfus Liquid Assets, Inc., after the date she claims to have left that bank. Since 1980, she has signed at least 5 Co-Op/St. Vincent checks from Dreyfus totaling more than $78,000. Baden also admitted to depositing funds in Co-Op/St. Vincent for Metropolitan Services, another corporation operated by Baden and Laurins.

PSI efforts to discuss these operations with the participants have proven fruitless. At the same time, serious questions have developed regarding how these banks were established and what functions they are undertaking. Records obtained by the Subcommittee raise serious questions about the creation of both Co-Op/St. Vincent and Co-Op/Anguilla, particularly pertaining to the asset capital required to license these banks.

Co-Op Investment Bank (St. Vincent)

There is evidence that Co-Op/St. Vincent has been in operation since 1978. In a May 17, 1983 telephone conversation Rene Baptiste, Managing Director of the St.

Vincent Trust Authority, told PSI that Co-Op/St. Vincent still licensed. Along with NS&T accounts, signature cards, checks and statements, PSI has obtained letters written on Co-Op/St. Vincent letterhead and advertising brochures touting it's services. Most conclusively, on November 20th, 1978 the Government of St. Vincent granted license No. 30/1978 to Co-Op/St. Vincent, subject to several conditions.

One important condition of license No. 30/1978 is that "the share capital of the company shall be fully paid up capital of not less than $500,000.00 of Eastern Caribbean Dollars." Five hundred thousand Eastern Caribbean Dollars is the equivalent of $187,500 U.S.* On December 1, 1978, Co-Op/St. Vincent was registered as an international bank with paid in share capital of $187,000 U.S. by the St. Vincent Trust Authority Ltd. with Registration No. 41 IC 1978.

How the License was Obtained

Neither the license (No. 30/1978) nor the registration (No. 41 IC 1978) indicate where the $187,500 came from. A November 15, 1978 resolution of Co-Op/Maryland resolves to "pay up the required initial share capital of Co-Op Investment Bank, Ltd., (Co-Op/St. Vincent), by payment of U.S. $187,500 by check attached and to be deposited in the organization account of Co-Op Investment Bank (Co-Op/St. Vincent) at National Savings and Trust, Washington,

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*In banking parlance, "initial share capital' is capital which must remain available so that the financial institution will have reserves on which to draw and by which to provide a solid foundation for the institution. According to the International Monetary Fund's Occasional Paper 17, "Aspects of the International Banking Safety Net", page 14, "A fundamental safeguard of bank solvency is the capital available to meet losses."

D.C." This resolution is signed by Charlene Baden as Secretary and Aleksandrs V. Laurins as Chairman.

On November 21, 1978 Laurins, as managing Director of Co-Op/Maryland sent a letter to Jerome Schneider of WFI enclosing that resolution and copies of a check and a deposit slip "showing that U.S. $187,500 has been paid in as capital for Co-Op Investment Bank Limited (Co-Op St. Vincent) to its organizational account at National Savings and Trust Company." Laurins requested that this information be sent to the St. Vincent Trust Authority so that the bank could begin doing business.

According to Co-Op/Maryland records, $187,000 was provided to the Co-Op/St. Vincent account from Co-Op/Maryland. This same representation was then made by WFI to the St. Vincent government. As proof of this transaction, a deposit ticket indicating a deposit of $187,500 to account number 1421913177 at the National Savings and Trust Company on November 20, 1978 at 2:02 p.m., was given by Laurins to WFI's Schneider and ultimately to St. Vincent. This deposit ticket was apparently provided to prove that the Co-Op/St. Vincent account #1421913177 at the NS&T Bank had $187,500 on deposit so that the government of St. Vincent could be sure that the newly licensed bank was suitable.

The Wash

In fact, a check payable to Co-Op/St. Vincent, for $187,500 was drawn from the Co-Op Investment Bankers' (Maryland) NS&T account #1421912708 on November 17, 1978. This check was deposited into Co-Op/St. Vincent NS&T account #1421913177 on November 20, 1978.

NS&T records indicate that the Co-Op/Maryland account on which the $187,500 was drawn had a balance of only $2,982.92 before that check was written. The monthly statement for this account shows that on the same day $187,500 was deposited. That $187,500 came from a November 17, 1978 check drawn by Alex Laurins from the Co-Op/St. Vincent account which had an actual balance of only $400.00. The monthly statements for both accounts show that on November 20, 1978, each account had a deposit of $187,500 and a withdrawal of $187,500.*

When questioned as to any possible reasons for such actions, the Vice President and Manager of the General Service Division of NS&T, could offer no logical reason for such a practice. He described the whole series of transactions as "a wash" since they resulted in no change to the balances of either account.

The key result of the transactions was the generation of a deposit ticket for $187,000; but this instrument did not really reflect what deposits were in fact on hand. It was this deposit ticket that was provided by Laurins, through Schneider to the government of St. Vincent purporting that the entity being licensed was adaquately capitalized. The initial share capital, a crucial attribute in providing security and legitimacy, was fabricated. The protections which St. Vincent supposedly warranted did not exist.

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*These same monthly statements clearly show that there was only one check in and one check out of each of the accounts on November 20, 1978. The check from Co-Op/Maryland to Co-Op/St. Vincent and the check from Co-Op/St. Vincent back to Co-Op/Maryland were those transactions.

This evidence indicates in making the presentation that "U.S. $187,500 has been paid in U.S. capital for Co-Op Investment Bank Limited," that the officers of Co-Op/Maryland and Co-Op/St. Vincent may have deceived the government of St. Vincent and, to facilitate this deception, utilized a bank to generate an instrument which presented an inaccurate representation of the financial status of a prospective licensee.

The severity of this problem is compounded by the fact that this may not be the only time that such misrepresentation has occurred.

Co-Op International Bank (Anguilla)

On August 10, 1979 Jerome Schneider, as "attorney-in-fact," for Co-Op/Maryland applied to the Minister of Finance of Anguilla for a banking license for Co-Op/Anguilla. The proposed directors and officers of this bank were two Anguillan residents and Aleksandrs V. Laurins.

Paragraph number five (5) of that application provides that the capital of the proposed bank will be Eastern Caribbean $500,000. Paragraph number six (6) states that the capital has been "paid in" and as evidence includes a document which purports to be the minutes of an August 7, 1979 meeting of the shareholders and organizers of Co-Op/Anguilla. Signed by "A.V. Laurins, Organizer" the document states that Co-Op/St. Vincent will open an organization account and will pay in U.S. $187,500 "of capital for Co-Op International Bank (West Indies) Limited" (Co-Op/Anguilla).

On August 28, 1979, the government of Anguilla incorporated Co-Op/Anguilla, No. 372. The certificate of incorporation certified the Memorandum and Articles of Association which specified on page 5 paragraph number 5 that "The capital is $500,000 E.C.". On August 31, 1979 the NS&T Bank in Washington, D.C. opened an account for Co-Op Anguilla (#142-191419-1) deposit of $100.00.

On September 6, 1979 the balance in the Co-Op/Anguilla account at NS&T was unchanged. The Co-Op/St. Vincent NS&T account had a balance of $14.07. Notwithstanding the balances of these two accounts, a now familar series of transactions took place. A check for $187,500, drawn on Co-Op/St. Vincent's NS&T account #142-19317-7 and signed by Charlene Baden was made payable to Co-Op/Anguilla and was deposited in its NS&T account #142-191419-1 at 12:02 p.m. At the same moment (12:02 p.m.), a check drawn on Co-Op/Anguilla's NS&T account for $187,500, signed by Charlene Baden made payable to Co-Op/St. Vincent, was deposited into Co-Op/St. Vincent's NS&T account #142-191317-7.

Once again, monthly statements indicate that there was only one deposit and one withdrawal for each account on the day in question. The check from one account was accepted by the other account and then merely returned to its source. Neither account could have covered such a check. The only way the accounts would balance would be by such a "wash". Again, the only result of the phantom transactions was a deposit ticket for precisely the amount required by a foreign government for asset capital to operate a recently incorporated bank.

It should be noted that PSI is aware that in October of 1978 Laurins and Baden applied for an international company license in St. Vincent for the Gold Depository

Bank and Trust Company, Ltd. While it is not known if such a license was granted, or under what circumstances, PSI has obtained an advertisement for The Gold Depository and Loan Company, operated by Mr. Laurins in San Francisco, which "sets up offshore banks, insurance companies, trusts and holding companies".

Conclusion

The PSI investigation of bank brokers and the apparently growing merchandising of foreign "brass plate" banks raises serious questions, particularly in light of the increasing evidence of the use of such entities in criminal schemes.

An increasing number of foreign countries appear to be willing to attract license fees by offering banks or corporations whose basic information is shielded by strict secrecy statutes. Law enforcement and regulatory authorities in the United States state that these statutes have been used in criminal schemes and to circumvent U.S. regulations. The secrecy laws of these countries can be used to secret assets, launder funds and circumvent requirements established to protect the integrity of U.S. markets.

While jurisdictions offering these banks and corporations set certain conditions on their ownership, such as limited background checks and required share capital, the effectiveness of these conditions is questionable, particularly in light of the U.S. bank brokers. PSI has found that some brokers care little about who buys their banks and how they are used. Even if the brokers makes a conscientious effort to screen clients, the brokers cannot determine if the client is only an agent for someone else nor can they ensure that such screening will not be circumvented by subsequent resale. Screening, without continued monitoring, is less than worthless if it provides the illusion of legitimacy where none exists.

Required share capital may provide the same false sense of security. If the generation of misleading instruments at any bank can be used as evidence of the stability and integrity of bank owners, then serious quesitons are raised as to the desire of the host nation to provide for legitimate corporation and/or banking licenses.

ATTACHMENT 1

WFI BANKS AND COMPANIES IDENTIFIED BY PSI STAFF FROM WFI RECORDS

ANGUILLA

- Caribbean Bank and Trust (1979)
- Co-op Investment Bank (1979)
- Pacific International Bank (1979)

CAYMAN ISLANDS

- American Atlantic Investment Company (1981)
- European American Investment Company

MONTSERRAT

- American Atlantic Bank (1981)
- American Bank of Commerce, Ltd. (1981)
- American International Bank, Ltd. (1980)
- American Overseas Bank, Ltd.
- American Pacific Investment Company
- Century Overseas Bank (1980)
- Chase Overseas Bank, Ltd. (1980)
- City International Bank (1980)
- Colonial International Bank, Ltd. (1981)
- Colonial Overseas Bank, Ltd. (1981)
- Commonwealth Bank, Ltd. (1981)
- Continental Overseas Bank, Ltd. (1980)
- Dominion Overseas Bank, Ltd. (1980)
- Fidelity International Bank, Ltd. (1980)
- First Security International (1980)
- Foreign Commerce Bank, Ltd. (1980)
- Heritage International Bank (1980)
- City International Bank, Ltd. and International Overseas Bank, Ltd. (1981)
- Investor's International Bank, Ltd. (1980)
- J. David Banking Company, Ltd. (1981)
- LaSalle Overseas Bank, Ltd. (1981)
- Manufacturers Overseas Bank (1981)
- Merchant International Bank (1981)
- North American Bank of Commerce (1981)
- North American Overseas Bank, Ltd. (1980)
- Pan An International Bank (1981)
- Regency International Bank, Ltd. (1981)
- Republic International Bank, Ltd. (1981)
- Securities Overseas Bank & Trust Company, Ltd. (1981)
- Swiss International Bank, Ltd. (1980)

- Swiss Overseas Bank, Ltd. (1982)
- Union Chartered Bank, Ltd. (1981)
- Union International Bank, Ltd. (1980)
- United Bank of Commerce (1981)
- United Overseas Bank, Ltd. (1981)
- W.C.T. Bank, Ltd. (1971)

PANAMA

- Caribbean Overseas Holding (1982)
- Intercontinental Bank, Ltd. (1981)
- Montserrat Financial Holding
- North American Overseas Holdings, S.A. (1981)
- Pacific Investment Fund, S.A.
- World Wide Investments Associations, Inc. (1981)

ST. VINCENT

- American Commerce Bank & Trust Company, West Indies, Ltd. (1980)
- American Fidelity Bank & Trust Company, W.I., Ltd. (1980)
- American Security Bank & Trust Company (1979)
- Bishop Bank & Trust Company (1978)
- Co-Op International Bank (W.I.) Ltd. (1979)
- European Overseas Bank, Ltd. (1978)
- Global Chartered Bank, Ltd. (1978)
- Kantor and Wolf Trust (1977)
- Nobel Bank & Trust
- Petrochem International Bank & Trust (1979)
- Regency International Bank & Trust Company
- Wellington International Bank & Trust (1981)

VANUATU

Trans Pacific International Bank (1981)

UNKNOWN

- American North Investment Company
- American Pacific Investment Company
- Caribbean International Bank, Ltd. (1981)
- Caribbean Overseas Bank, Ltd. (1981)
- Intercontinential Bank of Commerce, Ltd. (1982)
- Metropolitan Overseas Bank, Ltd. (1981)
- Midland International Bank (1982)
- Morgan Overseas Bank, Ltd. (1980)
- North American International Bank, Ltd. (1981)
- North American Investment Company

- Pacific National Bank
- Pacific Overseas Bank and Trust, W.I.
- Pacific Security Bank and Trust
- Union Bank & Trust Company, W.I.
- Union Commerce Bank & Trust Company (1981)
- Union Overseas Bank & Trust Company, W.I. (1979)
- United International Bank, Ltd. (1981)
- Western Overseas Bank, Ltd. (1981)
- World Security International Bank & Trust Company (1979)

WFI BANKS IDENTIFIED FROM OTHER SOURCES

COMMONWEALTH OF THE NORTHERN MARIANAS ISLANDS

- American Bank and Trust Company Limited
- American Chartered Bank Limited
- American Commerce Bank Limited
- Asian Commerce Bank Limited
- Asian Credit Bank Limited
- Colonial Bank of Commerce Limited
- Colonial Chartered Bank Limited
- Commercial Bank of Commerce Limited
- Commercial Chartered Bank Limited
- Commercial Credit Bank Limited
- Continental Bank of Trust Company Limited
- Continental Bank of Commerce Limited
- Continental Chartered Bank Limited
- Dominion Bank of Commerce Limited
- Dominion Chartered Bank Limited
- Dominion Commerce Bank Limited
- European Bank of Commerce Limited
- European Credit Bank Limited
- Fidelity Bank of Commerce Limited
- Fidelity Chartered Bank Limited
- First American Bank Limited
- First Fidelity Bank Limited
- First Global Bank Limited
- First International Bank Limited
- First North Western Bank Limited
- First Pacific Bank Limited
- First Republic Bank Limited
- Gibraltar Chartered Bank Limited
- Global Bank and Trust Company Limited
- Global Bank of Commerce Limited
- Global Credit Bank Limited
- Heritage Bank and Trust Company Limited
- Heritage Chartered Bank Limited
- Merchants Bank of Commerce Limited
- Merchants Chartered Bank Limited
- Merchants Credit Bank Limited

- North American Bank and Trust Company Limited
- North American Chartered Bank Limited
- North Western Bank of Commerce Limited
- North Western Chartered Bank Limited
- Pacific Bank and Trust Company Limited
- Pacific Bank of Commerce Limited
- Republic Bank and Trust Company Limited
- Republic Bank of Commerce Limited
- Republic Chartered Bank Limited
- Royal Bank and Trust Company Limited
- Royal Chartered Bank Limited
- Royal Credit Bank Limited

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Outside California 800-421-4177

PREPARED STATEMENT OF JEROME SCHNEIDER

PRESIDENT, WFI CORPORATION
INTERNATIONAL FINANCIAL CONSULTANTS
LOS ANGELES, CALIFORNIA

CONCERNING THE PROBLEMS ARISING FROM THE OWNERSHIP AND USE OF OFFSHORE BANKS AND PROPOSED REMEDIES; AND PRESERVATION OF THE RIGHTS OF AMERICANS TO COMPETE FOR, AND ENGAGE IN LEGITIMATE INTERNATIONAL BANKING BUSINESS AND TO MAINTAIN FINANCIAL PRIVACY, PROBLEMS AND PROPOSED REMEDIES

BEFORE THE
SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

MAY 24, 1983

Mr. Chairman and members of the Subcommittee:

Thank you for the opportunity to appear before you today to present the views of WFI Corporation and of myself regarding the problems arising from the use and ownership of offshore banks. We welcome these hearings graciously. It is this type of forum that provides an opportunity to clear up the many misconceptions created by the news media about the legitimacy of offshore banking.

Before I begin, I would like to define the subject I will be discussing today. I will be discussing the problems arising solely from the use of offshore banks by offshore bank owners as distinguished from offshore bank customers.

Placed in the context of my discussion, an offshore bank is a corporation organized and licensed under the banking laws of a foreign country or a foreign jurisdiction that is conducive to conducting international financial transactions with minimal tax, banking, and security regulations. These types of banks are often called "Class B" offshore banks because the law permits the bank to deal only with persons who are non-residents of the host country. In this context, these are true offshore banks because they gain their business from off the shores of the country from which their license and charter has been issued.

Mr. Chairman and Subcommittee members, I feel that I am adequately qualified to present expert testimony here today. I am president of a consulting firm, which for the last seven years has counselled, advised, and helped establish offshore banks for large corporations, small companies, and individuals in this country and abroad. My clients have ranged from Swiss bankers to American entrepreneurs to international money traders. I am the author of two books on the subject of owning an offshore bank and have lectured extensively at financial seminars and conferences in this country and abroad. I have studied the 253-page report produced by this Subcommittee's staff as well as the written statements presented by Glenn L. Archer Jr., Assistant Attorney General, Tax Division, U.S. Department of Justice, the staff statement dated March 15, 1983, testimony by William von Raab, Commissioner of Customs, and statement of Roscoe L. Egger Jr., Commissioner of the Internal Revenue Service, dated March 15, 1983.

It is my opinion that the staff study and testimony given to date has fallen short of presenting a balanced point of view on these issues. Clearly, the conclusion that one reaches at this point is that offshore banking and offshore banks are bad. In order to present the American public with a balanced point of view, it is essential that this Subcommittee call witnesses like Mark Yarry who is the Managing Director of J. David Banking, an offshore bank which is engaged in wholly legitimate activities, and others like him who can demonstrate that offshore banks have positive, beneficial, and legitimate uses. In addition, I urge this Subcommittee to call officials from Merrill Lynch and Dow Chemical Company so they can explain to the American public how they are legitimately and positively using their offshore banks.

My testimony should not be the final word. My role today will be to outline and briefly explain the legitimate non-criminal reasons for owning an offshore bank.

Before I explain the problems arising from the ownership and use of offshore banks, I would like to explain the role of WFI Corporation in the offshore bank acquisition process. WFI was founded by myself in 1976 as a consulting firm to assist persons, whether they be Americans or foreign nationals, with establishing an offshore bank in a favorable jurisdiction. The price that WFI charges for an offshore bank is approximately $35,000. As part of the sales process, it has become necessary to administer warning and discrete advice to each prospective bank owner regarding the benefits and risks associated with owning an offshore bank. I, nor any of my employees, are attorneys or CPA's, and we are not licensed to render legal or accounting advice. Our relationship with an offshore bank owner stops immediately after the acquisition process is completed.

WFI's activities are completely legal and above board. We are not tax protestors, radicals, or tax advisors that advocate tax fraud. All of the techniques, strategies, and procedures illustrated by WFI have been checked by competent attorneys and found to be completely legal and above board.

The applicant screening process used by WFI which has evolved over the years, is considered as strict as the screening process the Federal Deposit Insurance Corporation administers to prospective bank owner applicants for a U.S. bank. I would like to share with you some of the highlights of this process:

First, at a sales orientation meeting, WFI makes a considerable effort to determine the prospective owner's motives. Questions are asked such as, "What do you intend to do with this bank?", "Do you have lawyers that can advise you of the legality of using this bank in conjunction with your application?", and "Have you ever been convicted of a past criminal offense?" These and other questions are routinely asked during the sales meetings. In addition, to prevent a prospective owner from believing that an offshore bank is an instrumentality of tax fraud, we advise each person of his tax reporting obligations associated with owning an offshore bank. We explain the important differences between tax avoidance and tax evasion. We explain that an offshore bank cannot be used to issue financial instruments without having sufficient capital or funds to back them up.

When a purchase is consummated, both orally and in writing, the purchaser acknowledges that he understands that the banking, tax and securities laws of the United States and of the individual States are complex and that any activity conducted within the United States must be done with the guidance and advice of a competent attorney. The purchaser further acknowledges that he is responsible for reporting the ownership of his bank to the Internal Revenue Service within 90 days from the date of purchase and that he may be responsible for filing other forms annually with the IRS. A copy of this specific representation has been appended as part of my statement annexed Exhibit "A."

In addition to these representations made in writing to us prior to the purchase of a bank, WFI commissions an independent background investigation on the bank's beneficial owner and other persons who plan to be officers, directors, and agents to the bank. These background investigations cost WFI anywhere from $500 to $1,000 per report. These reports are highly useful in determining the motives and bonafides of a prospective bank owner. The report includes a check of both civil and criminal court records dating back for seven years in the city where the applicant has lived the longest. In addition, interviews are conducted with the applicant's banker and business associates to ascertain the character and reputation of the applicant. This entire process is known as "vetting." I note that we are the only organization in America that performs such checks when selling an offshore bank to a prospective owner.

The question then becomes, does all this checking really work? Our record speaks for itself. Since 1976 WFI has sold 120 offshore banks. Out of the 120 offshore banks legally authorized to do business, only one was found to be engaged in fraudulent activity after purchase.

In perspective, you might ask, have we ever turned anybody down? The answer is yes. On September 15, 1980, we were asked by William Posnet Lynas III to sell him an offshore bank. We advised him of our background checking procedure, and he recommended that in the event that he did not check out, he would like his secretary, Mrs. Traylor, to be the beneficial owner. The next day we commissioned a background report on both himself and Mrs. Traylor and found that Mr. Lynas was convicted for smuggling fifty-five pounds of cocaine into the United States and was sentenced to nine years in prison and twenty months probation on March 29, 1976. A copy of the background report produced by Equifax, a private investigation firm engaged in the service of providing such reports, on Mr. Lynas is appended to my statement for your information as "Exhibit B". Immediately after receiving the knowledge that Mr. Lynas was convicted of such a crime, we refunded his money and sent him a letter explaining the situation. A copy of our letter dated September 25, 1980 and a photocopy of the front and back of our refund check to Mr. Lynas for $33,000 is also appended to my statement and made a part of this record as part of Exhibit "B." I believe that this action in itself demonstrates our integrity and our above-board intentions to only sell banks to persons who are legitimate and have legitimate reasons for owning an offshore bank.

Of the 150 cases cited in the Subcommittee's study involving offshore criminality, I believe that many of these frauds could have been averted if this type of applicant vetting would have been administered prior to the supplying of an offshore bank to the owner.

I have an observation which this Subcommittee should take into account in studying the phenomena of offshore bank criminality. The question is, do offshore criminals really need to buy an offshore bank charter and license in order to commit a fraud? The answer is clearly no. One case which for some reason was not cited in the study prepared by the Subcommittee's staff was the $40 million Bank of Sark fraud, considered by many as the granddaddy of all offshore bank crimes. The criminals that perpetrated this fraud did not have an offshore bank charter, license, or any official documentation from the Government of Sark authorizing them to conduct banking business. This same situation occurred in other fraud cases such as, U.S. v. Crosby, U.S. v. Fedderbush, U.S. v. McDivitt, U.S. v. Parker, and others who had expired or disenfranchised bank charters at the time they committed their frauds. To a great extent these frauds were initiated simply by printing up phony checks or other financial instruments with the name of a bank and obtaining a third party to sign such instruments. It clearly would be illogical for an offshore criminal, if his intent is to commit a fraud, to pay $35,000 to WFI Corporation for an offshore bank charter and license if he could commit the fraud simply by finding the name of a bank which is not registered and licensed anywhere and printing up phony financial documents in that name. If controls and new legislation are contemplated to curb this activity, it should be directed toward printers who print up such documents; to compel them to check the legitimacy of such institutions prior to printing documents, and to the commercial banks who establish bank accounts in the name of non-existent institutions.

I would like to mention one country's practices for the record. The country is Anguilla. I have attached a list as Exhibit "C" of sixty "Class B" offshore banks, all licensed and legally able to operate in the British colony of Anguilla. The list was published in the Official Gazette January 28, 1983. Anguilla is probably the best example in the world of a country, which in my opinion, does not vet bank license applicants carefully. My two competitors, Charles Cranford of Amarillo, Texas, and Gordon Novell of Metairie, Louisiana, will sell you an offshore bank for cash with no questions asked. The reason these gentlemen are able to provide such an incredible service is that the Government of Anguilla does not scrutinize or approve the subsequent transfer of ownership of banks once they are licensed. This affords the criminal the opportunity to acquire a bank charter without any background checks or any intelligence data accessible by a law enforcement agency that can determine whom the operatives of the bank are. In many cases, one can fly down to Anguilla and acquire a bank charter simply by providing two banking references which, I understand, are not checked. I believe that Anguilla is a time bomb waiting to blow up and urge this Subcommittee to dedicate its investigative resources and legislative efforts to curb the practices permitted by the Government of Anguilla.

Because of these practices, WFI in no way places any of its clients there. Instead, we use countries that are interested in vetted applications and make certain that its chartered banks do no fall into the hands of criminals.

The orientation and directions of this Subcommittee seems to be directed toward inhibiting Americans from owning their own offshore bank. It has cited many cases in which offshore banks have been used as an integral part of a criminal scheme, but has not discussed or even considered on an equal basis the idea that an offshore bank owned by a businessman or investor may be beneficial to the U.S. economy itself. In this connection, it is important for this Subcommittee to recognize that it must preserve the rights of Americans to compete for and engage in legitimate international banking business. Since the evolution of the Eurodollar market, its main users have been only major multi-million dollar institutions. The Eurodollar plays an important role in providing capital for America's major industrial corporations. WFI believes that the smaller businessmen and investors can tap the resources of the Eurodollar market with the right legal structures, advice, and opportunity. Such an opportunity exists with the use of an offshore bank owned by a domestic corporation who wishes to compete in the international certificate of deposit (ICD) market in Europe by placing his obligations with brokers who can locate suitable Eurodollar market investors. My critics believe that no one other than a name like General Motors or Ford will be taken seriously in Europe. This is not so. Hundreds of high technology venture capital deals are consummated every day in Europe and are done so on a private basis. Given this stage, the offshore bank becomes an excellent vehicle for intermediation by providing a path to the U.S. with minimal tax and securities regulation involvement. I mentioned J. David Banking Company. This bank was an offshore bank WFI established for J. David Company, a multi-million dollar brokerage concern based in La

Jolla, California. J. David Banking is used as an intermediary for foreign exchange trading to channel investment dollars into the United States in a wholly legitimate manner. It is this type of activity that underscores the legitimate use of offshore banks. It has been the efforts of WFI Corporation to promote this positive and beneficial use to other small businessmen and investors so they, too, can locate badly needed capital in the same manner.

Working against us, with great vigor, is one individual at the Compliance and Enforcement Division of the Office of Comptroller of Currency (OCC). He is Mr. John Shocky. Mr. Shocky states unequivocally that "I am unaware of any 'shell' bank ever being used for legitimate purposes." In addition, Mr. Shocky routinely sends banking issuance circulars to the news media warning the business community of offshore bank fraud, thus casting a dark cloud over all offshore banks. Mr. Shocky believes that there is no place for the small to medium size businessman in the international banking business. He believes that only major industrial corporations and banks can legitimately operate offshore banks. It is this type of blacklisting and innuendo from a position of authority which has caused the news media to develop misconceptions about the legitimacy of offshore banks.

In addition to the activity of financial intermediation which is clearly a legitimate activity for offshore banks, banks can provide foreigners with international banking services such as certificate of deposit accounts and other important banking services. Individuals who may not have the capital and expertise to qualify for a State or Federal bank charter need a place to turn to if they want to make a go of banking. For this reason, countries like Montserrat and the Mariana Islands have adopted regulations to prevent undesirable persons from retaining and holding banking licenses while at the same time making bank ownership or bank participation reachable by the small to medium sized investor or businessman with minimal red-tape.

This Subcommittee's staff investigators have asked me to explain why people acquire their own offshore banks. In a survey conducted late last year, we found that more than fifty percent of the persons who acquired offshore banks from us acquired them strictly for status or prestige. They have no intention of using them or doing anything with them. They are strictly benign entities. This may seem foolish to some of us to spend $35,000 for this reason, but for some it is like having a second Rolls Royce. It is my opinion that this Subcommittee should not think negatively of any person if he wishes to own a bank merely to fulfill a dream or for the sake of saying that he owns a bank.

There is another legitimate reason for wishing to own an offshore bank: financial privacy. One of the fundamental principles this country was founded on is the concept that an individual has the right to conduct his business without the ever-watchful eye of "big brother." Clearly, the orientation of this Subcommittee seems to equate the idea that if no one is watching him, he will commit a crime. The title, "Crime and Secrecy: The Use Of Offshore Companies and Banks" suggests clearly that the two, crime and secrecy, are synonymous. Thinking in terms of absolutes, in the absence of all privacy and confidentiality of all financial transactions, crime would be impossible. Liberty, of course, would also be impossible. Therefore, a balance must be struck between no disclosure versus full disclosure. In this context, an offshore bank provides a bank owner with an opportunity to achieve a greater degree of financial privacy beyond the assurance, if any, accorded to him by the Fair Credit Reporting Act of 1970 and the Financial Privacy Act of 1978. Clearly, a wealthy investor or businessman has little or no privacy from third parties solely because of the availability of bank records in the U.S. The cases in this area support the position that this is a "bare all" society and that a bank has little if any obligation to protect the confidentiality of bank records. In both, California Banker's Association v. Shultz and U.S. v. Miller, the courts have found that banks are an open file cabinet for any person with "official" access.

By advocating financial privacy, this Subcommittee might think that I am trying to impair the ability of the Government to conduct criminal, tax or other regulatory investigations. I am not saying that. I firmly believe that if Government law enforcement agents are investigating a crime, they should have the full right to investigate any person suspected of such a crime upon probable cause. If bank records provide an efficient medium through which such an investigation may be conducted, then bank records should be used. However, as banks are useful custodians of records for the Government, they are also useful custodians of records for private parties. These private parties may not be as honest and ethical as one might think. They might be an aggressive competitor seeking to learn as much as possible about his competitor, such as the names of suppliers which can be learned from bank records. He may be a highly litigious and unscrupulous person working in concert with an aggressive and skilled lawyer to file a nuisance law suit against someone wealthy enough to simply pay off a settlement rather than to fight. Or, the privacy perpetrator might be a potential thief who may wish to find out how much money someone has and may use a U.S. bank as his information supplier. The Fair Credit and Reporting Act mandates specifically that a credit report like a TRW Credit Report cannot be furnished to an attorney involved in litigation. However, attorneys seem to always know where the money is. The TRW report lists assets and bank accounts that are highly useful when sizing up a litigation target.

The technique that is often used by attorneys to gain such TRW reports is to employ the services of a private investigator who is often a subscriber to the TRW service which will provide to the attorney such reports. Hence, the law is not broken and an attorney is provided with detailed financial information about his new litigation target.

By owning an offshore bank an investor or businessman is given the opportunity to gain a degree of insulation by placing his larger assets in the the name of the offshore bank, thus not exposing those assets to credit reporting services. It is not the intention of this person to commit tax fraud or to hide something from the IRS because he knows that if he acquires the ownership of an offshore bank he must file with the Internal Revenue Service.

In conclusion and statistically speaking, offshore bank criminality can occur without owning an offshore bank charter and license. Evidence as such can be seen by studying the historic Bank of Sark fraud which amassed forty million in losses. I believe the only way to prevent such frauds is to license and control printers who print documents for such banks and to make it mandatory for bankers to check the validity of an offshore bank charter and license prior to establishing any type of financial account in its name. From the point of view of supplying offshore bank charters and licenses, the vetting process is essential. Perhaps an international standard for bank license application vetting should be initiated. The procedures established by WFI are of its own design and theme, and our good record demonstrates it works. In addition, this Subcommittee should recognize that offshore banks owned by an individual or corporation have positive and beneficial uses which are wholly legal. It would be unfair to encumber or impair the rights of Americans to compete for and engage in legitimate international banking business. By casting the stigma of criminality to offshore banks, the small to medium sized businessman will always be afraid of considering the option. Finally, While I agree that it is important to use "big brother" techniques to thwart the activities of criminals, it is important to preserve the rights of law-abiding Americans who wish to protect the confidentiality of their business records by using an offshore bank.

This completes my prepared statement, thank you.

FOR UNITED STATES RESIDENTS OR CITIZENS ONLY:
These are your reporting obligations to the Internal Revenue Service

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Failure to comply may result in criminal or civil penalties — read this carefully
(Instructions: please read and sign below where indicated)

THE UNDERSIGNED, ON THE DATE WRITTEN BELOW, HEREBY ACKNOWLEDGES THAT HE HAS BEEN FULLY INFORMED BY WFI CORPORATION OF HIS REPORTING DUTIES PURSUANT TO CERTAIN PROVISIONS OF UNITED STATES LAW.

THE UNDERSIGNED HEREBY UNDERSTANDS AND ACKNOWLEDGES THAT IF HE IS AN OWNER, EITHER DIRECTLY OR INDIRECTLY, OF A FOREIGN REGISTERED CORPORATION, TRUST, OR BANK, HE MAY BE REQUIRED TO FILE SOME OR ALL OF THE FOLLOWING FORMS WITH THE IRS IN CONNECTION WITH HIS OWNERSHIP:

1. **FORM 3520** — THIS FORM IS REQUIRED OF ALL U.S. RESIDENTS WHO CREATE A FOREIGN SITUS TRUST OR TRANSFER PROPERTY TO A FOREIGN SITUS TRUST. IT SHOULD BE NOTED THAT THE REPORTING DUTY COVERS INDIRECT TRANSFERS THROUGH FOREIGN INDIVIDUALS AND ENTITIES AS WELL AS DIRECT TRANSFERS. THIS MUST BE FILED **90 DAYS** AFTER CREATION OR TRANSFER OF ASSETS TO THE TRUST.

2. **FORM 926** — THIS FORM IS REQUIRED OF ALL INDIVIDUALS MAKING TRANSFERS OF APPRECIATED PROPERTY TO FOREIGN TRUST, CORPORATIONS OR PARTNERSHIPS FOR LESS THAN ADEQUATE CONSIDERATION.

FOR FAILURE TO FILE, THE IRS CAN IMPOSE A FINE AS WELL AS CRIMINAL PENALTIES.

3. **FORM 3646** — IF MORE THAN 50% OF THE VOTING SHARES OF A FOREIGN CORPORATION ARE OWNED BY U.S. INDIVIDUALS OR CORPORATIONS EACH OF WHOM OWNS 10% OR MORE OF THE VOTING SHARES OF THE CORPORATION, THAT CORPORATION IS A CONTROLLED FOREIGN CORPORATION AND EACH OWNER OF 10% OR MORE OF THE VOTING SHARES IS TAXED CURRENTLY ON CERTAIN TYPES OF CORPORATE INCOME. EACH U.S. OWNER OF 10% OF THE VOTING SHARES MUST FILE THIS FORM EACH YEAR TO REPORT HIS RATABLE SHARE OF THE CORPORATION'S SUBPART F INCOME.

IT SHOULD BE NOTED THAT MERE NOMINEES WHO HAVE NO REAL VOTING OR ECONOMIC INTEREST IN THE CORPORATION ARE DISREGARDED FOR PURPOSES OF DETERMINING WHO IS A REAL SHAREHOLDER FOR REPORTING PURPOSES.

AGAIN, THERE ARE VARIOUS CIVIL AND CRIMINAL PENALTIES FOR NOT FILING.

4. **FORM 957** — IF 50% OR MORE IN VALUE OF THE STOCK OF A FOREIGN CORPORATION IS OWNED BY FIVE OR FEWER U.S. INDIVIDUALS, THE CORPORATION IS A FOREIGN PERSONAL HOLDING COMPANY, AND EACH U.S. SHAREHOLDER IS TAXED CURRENTLY ON CERTAIN FORMS OF INCOME EARNED BY THE CORPORATION. EACH U.S. OFFICER OR DIRECTOR MUST FILE A FORM 957 EACH YEAR. FORM 957 IS ALSO REQUIRED OF U.S. INDIVIDUALS WHO OWN 50% OR MORE IN VALUE OF THE STOCK OF THE CORPORATIONS.

THE USUAL CIVIL AND CRIMINAL PENALTIES APPLY FOR FAILURE TO FILE.

TWO OTHER ITEMS SHOULD BE NOTED. FIRST, MERE NOMINEES ARE DISREGARDED IN DETERMINING SHARE OWNERSHIP. SECOND, IF A CORPORATION IS CLASSIFIED AS A FOREIGN PERSONAL HOLDING COMPANY, IT CANNOT ALSO BE CLASSIFIED AS A CONTROLLED FOREIGN CORPORATION.

5. **FORM 958** — EACH U.S. RESIDENT WHO IS AN OFFICER OR DIRECTOR OF A FOREIGN PERSONAL HOLDING COMPANY IS REQUIRED TO FILE YEARLY REPORTS OF THE INCOME OF THE CORPORATION.

THERE ARE THE USUAL CIVIL AND CRIMINAL PENALTIES FOR FAILURE TO FILE.

6. **FORM 959** — EVERY U.S. CITIZEN WHO IS AN OFFICER OR DIRECTOR OF A FOREIGN CORPORATION MUST REPORT ON THIS FORM EVERY ACQUISITION OF 5% OR MORE OF THE VALUE OF THE STOCK OF THE FOREIGN CORPORATION BY A U.S. PERSON.

EACH U.S. PERSON WHO ACQUIRES 5% OR MORE IN VALUE OF THE SHARES OF A FOREIGN CORPORATION ALSO HAS A DUTY TO REPORT HIS ACQUISITION. THIS MUST BE FILED 90 DAYS AFTER SUBSCRIPTION OF CORPORATE SHARES.

THERE ARE THE USUAL CIVIL AND CRIMINAL PENALTIES FOR FAILURE TO FILE.

7. **FORM 2952** — THIS ANNUAL RETURN MUST BE FILED BY EVERY U.S. PERSON WHO OWNS MORE THAN 50% OF THE VOTING STOCK OF A FOREIGN CORPORATION. THE USUAL PENALTIES APPLY.

8. **FORM 90-22.1** — THIS FORM MUST BE FILED ANNUALLY BY EVERY U.S. PERSON WHO HAS AN INTEREST IN A FOREIGN FINANCIAL ACCOUNT.

THE FORM IS REQUIRED OF ALL U.S. PERSONS WHO MAINTAIN BANK OR SECURITIES DEPOSITS ABROAD, WHETHER IN THEIR OWN NAME OR IN THE NAME OF THE NOMINEE. IT IS REQUIRED EVEN IF *ORAL* AUTHORITY IS EXERCISED OVER THE ACCOUNT.

IF THE ACCOUNT IS MAINTAINED BY A FOREIGN TRUST, THE FORM MUST BE FILED BY ANY U.S. PERSON WHO HAS A 50% OR GREATER BENEFICIAL INTEREST IN TRUST INCOME. THE USUAL FINES AND PENALTIES APPLY.

9. **FORM 4790** — THIS FORM MUST BE FILED BY EACH PERSON WHO PHYSICALLY TRANSPORTS, MAILS, SHIPS, OR CAUSES THE SAME, CURRENCY OR OTHER MONETARY INSTRUMENTS EXCEEDING $5,000 ON ANY ONE OCCASION INTO OR OUT OF THE UNITED STATES. THIS FILING IS NOT REQUIRED FOR FUNDS TRANSFERRED THROUGH NORMAL BANKING PROCEDURES NOT INVOLVING PHYSICAL TRANSPORTATION OF ANY INSTRUMENT. THE USUAL FINES AND PENALTIES APPLY.

10. **FORM 1120F** — EVERY FOREIGN CORPORATION WHICH IS ENGAGED IN A TRADE OR BUSINESS IN THE U.S. MUST FILE THIS FORM ANNUALLY. THE USUAL FINES AND PENALTIES APPLY.

11. **FORM 6660** — EVERY FOREIGN CORPORATION WHICH OWNS U.S. OR VIRGIN ISLANDS REAL ESTATE MUST FILE THIS FORM ANNUALLY. CHECK IRC SECTION 6039 (C) FOR APPLICABLE DETAILS AND EXEMPTIONS. THE USUAL PENALITIES APPLY.

THE UNDERSIGNED FURTHER ACKNOWLEDGES THAT HE SHOULD CONTACT HIS TAX ADVISOR, CPA, OR ATTORNEY TO ASCERTAIN WHICH FORMS ARE APPLICABLE IN HIS SITUATION.

IT IS UNDERSTOOD THAT WFI CORPORATION, OR ANY OF ITS OFFICERS, EMPLOYEES, OR AGENTS HAVE ADVISED AND RECOMMENDED THAT THE UNDERSIGNED COMPLY WITH THE VARIOUS REPORTING OBLIGATIONS AS SET FORTH ABOVE. IT IS FURTHER UNDERSTOOD THAT IT IS THE OBLIGATION OF THE UNDERSIGNED TO COMPLY, AND THE LIABILITY FOR NON-COMPLIANCE SHALL REMAIN WITH THE UNDERSIGNED.

EXECUTED THIS ________ DAY OF ______________________________ 19 _____ AT ______________________________.

(WHERE EXECUTED)

______________________________ (NAME OF BANK)

X ______________________________ (SIGNATURE)

______________________________ (NAME PRINTED)

______________________________ (SIGNATURE)

______________________________ (CITY, STATE, ZIP)

PA/B 8-80

EXHIBIT "A"

Equifax Services

CONFIDENTIAL

Acct. No. 411-506
9-23-80-17-17
LYNAS, WILLIAM POSNETT III
Newport Beach, CA, 919 Bayside Dr.
Sanyl International Management Inc.
Newport Beach, CA, 919 Bayside Dr. #[illegible]-3
Date of Birth 45yrs.
Coverage ns

Agcy-Br. ns
Pol.-File # ns

Santa Ana OFFICE

REPORT FROM ________ (If not city in heading) ________ (State whether former addr., etc.)

Spec. Serv. Char.-Fin.
Kind of report

Class

PROPERTY RECORDS: Negative regarding any property owned by your subject in Orange County.

COURT RECORDS: Aside from court records below, we made a thorough search of Orange County Court records which included Superior Court records both plaintiff and defendant going back to 1968, Municipal Court records both plaintiff and defendant going back to 1968 and these included both Civil and Criminal records. Negative regarding anything under the name of W. Posnett Lynas III or William Posnett Lynas III.

BANKRUPTCY RECORDS: Negative regarding any bankruptcy records regarding W. Posnett Lynas or William Posnett Lynas going back approximately eight years. These are Federal Bankruptcy records for the Orange County area.

FEDERAL COURT RECORDS(LAGUNA NIGUEL, CA): Please refer to the attached information obtained by an alternate investigator at this location as attached.

Regarding the hearing on 1-14-76 where bail was set at $500,000 the outcome of that particular case was not available at the Laguna Niguel branch of Federal Court records as this location is mainly a storage area. We highly recommend that Los Angeles Federal Court records be rechecked to determine the outcome of this particular court action. Should you desire such handling after reviewing this investigation, please advise our Los Angeles offices and they will assist you immediately.

The alternate investigator did obtain photocopies of the attached six pages of Federal Court documents which also include a financial affidavit on William P. Lynas as of July 24th, 1974. We also obtained a photocopy of the attached Federal Court document number 9203-CR filed 1-14-76 indicating United States of America versus William Posnett Lynas regarding "conspiracy to import controlled substance" in violation of 21USC963. Please refer to the attached documents for additional details.

Equifax Services Inc.
Equifax Services Ltd.
Form 100—1-79 U.S.A.

Report transferred on ________ To ________
(date) (branch office)

EXHIBIT "B"

COURT RECORDS: Under a Grand Jury indictment case number 9203 filed 11-24-71 in the Federal U.S. District Court in Los Angeles we find the following:

The subject was charged with violation 21-USC-963, conspiracy to import controlled substance.

On or about 10-27-70 and continuing into 1971 William P. Lynas and co-conspirators, Jack Voohries, Illeen Felshaw, Candice Shivers, Darryl McCullough and others conspired to import cocaine into the United States. The cocaine was to be placed in film cannisters placed in United Film Club mailing envelopes and mailed to the United States from Chile to P.O. Box 25969, West Los Angeles Post Office. William P. Lynas would arrange for distribution to the customers and retain most of the profits from this action.

1. On 10-27-70 he filled out an application to rent a P.O. Box using the name of William Heimbach.

2. On 10-13-71 an unknown co-conspirator in Chile mailed 30 mailers containing cocaine from Chile to P.O. Box 25969 West Los Angeles.

3. On 10-14-71 an unknown co-conspimator mailed 57 mailers to the United Film Club, P.O. Box 25969, West Los Angeles.

4. On Jack Voorhies using the name of Sammy Martin signed for ten mailers containing cocaine on 8-18-71.

5. On 8-21-71 Jack Voorhies using the name Sammy Martin signed for ten mailers containing cocaine.

6. Darryl McCullough using the name Dennis Copping signed for 54 mailers on 9-1-71. The mailers contained cocaine.

7. On 9-10-71 Jack Voorhies using the name Sammy Martin signed for 14 mailers that contained cocaine.

8. On 10-12-71 Illeen Felshaw using the name Karen Tracey signed for 20 mailers containing cocaine.

9. On 10-13-71 an unknown co-conspirator from Chile mailed 30 film mailers to the P.O. Box 25969 in West Los Angeles.

10. On 10-14-71 an unknown co-conspirator from Chile mailed 57 film mailer envelopes to the United States to the P.O. Box 25969 in West Los Angeles.

11. On 10-20-71 Candice Shivers using the name Cathy Rogers signed for 57 mailers containing cocaine.

12. On 10-20-71 Candice Shivers using the name Cathy Rogers signed for 26 mailers containing cocaine.

On or about 10-20-71 the defendant William Posnett Lynas and Ileen Felshaw knowingly and intentionally imported 19 pounds of cocaine.

On 1-5-76 the above case was dismissed by Judge Manuel L. Real in the U.S. District Court in Los Angeles. The attorney for Mr. Lynas was shown as Howard W. Gillingham.

Under case number 10674-CD filed 7-6-72: This was a Federal Grand Jury indictment for conspiracy.

The records indicate the United States of America versus William Posnett Lynas. He was charged with violation of 21USC952A; 960A. Importing into the United States controlled substances.

Also violation of 21USC841A, possession of controlled substance. Violation of 18USC-2, aiding and abetting.

On or about 10-27-70 William Posnett Lynas and others conspired to import into the United States from Chile controlled substances.

1. On 10-27-70 Mr. Lynas filled out an application to rent P.O. Box 25969 at the West Los Angeles Post Office. He was using the name of William Heimbach.

2. On 7-20-71 Illeen Felshaw using the name of Carol Wright signed for received 19 mailers containing cocaine.

3. On 8-3-71 Illeen Felshaw using the name Karen Tracey received 20 mailers containing cocaine and signed for them.

This case was ordered dismissed on 1-5-76 in the U.S. District Court in Los Angeles by Judge Manuel L. Real.

There is another criminal case involving the subject, case number 9731 that was not in the Laguna Niguel Courthouse records. This case was also ordered dismissed on 1-5-76 by Jude Manuel Real in the U.S. Federal District Court in Los Angeles.

The records indicate that the applicant was born 12-27-34. He was held in Switzerland between 1972 and 1976 fighting extradition hearings.

The records also indicate he was convicted on 10-6-64 for two counts of obtaining money under false pretenses. He was wanted for parole violation in 1970. Applicant had various bank accounts in Canada, Switzerland and Panama. He was also known to use the name of Carl Heintz. Bail was set at $150,000 on 4-25-72.

There was another hearing on 1-14-76 and bail at that time was set at $500,000.

There was another hearing on 7-1-74 an exparte motion of four arrests held in the Federal District Court in Los Angeles. Bail at that time was set at $500,000.

On 12-12-74 while living in Switzerland the subject wrote a letter to Supreme Court Justice William O. Douglas for relief from the District Court's refusal to appoint counsel and an investigator regarding the charges that were outstanding against him.

At the time the letter was written he listed a home address of Bezirksgefangnis, CH-8910-AFFOLTERN, AM-ALBIS Switzerland.

We were also able to obtain photostatic copies of several documents including a financial affidavit that the applicant had signed on 7-24-74 listing assets and liabilities.

Manager-Newport Marina Apts.-919 Bayside Dr., Newport Beach: This source has known your subject for approximately 1½ years and indicated that he has been renting at this address since April 3rd, 1979. He is known as a very good tenant who always pays his rent on time. This source absolutely refused any further information regarding your subject and even refused the amount of rent per month he pays. We were told that this is located in an upper income area next to the Pacific Ocean in a highly desireable rental area. We developed no adverse information regarding your subject's finances or character through this source.

We attempted to obtain interviews with tenants in this complex but were refused admittance due to the policy of the apartment complex itself.

We were able to secure an interview with Clarice Marian Traylor on 9-17-80. She stated that your subject is a doctor but she did not know what type of doctor he is. She stated that she has known your subject for about two or three years and indicated that your subject currently resides in Switzerland. She indicated that she telephoned your subject overseas a good deal to keep in business contact with him. Your subject will occasionally come to the United States for business meetings with this source and other company members. When your subject is in town, he usually stays at his apartment located at 919 Bayside Drive, #H-3 in Newport Beach, California. Your subject can currently be reached in care of 13 Rue Chaponniere, zip 1201 Geneva,-1 Switzerland. Your

Page 5 Account No. 411-506

Continuation of Report on LYNAS, WILLIAM P. File Identification ns

subject is currently the vice president of Sanyl International Management. Clarice Traylor had no idea what your subject's net worth was and was not familiar with your subject's personal or business finances. She did not even know whether your subject was married as he spends a good deal of his time in Switzerland and travels much throughout the European continent and may even have a home in London, England. Clarice Traylor could give us no trade references for your subject or specific business or banking references on him. She did go into quite some length regarding the details of the business and we will be submitting this information to you under separate cover regarding our report on Clarice Marian Traylor which will accompany this report. Therefore, please refer to that separate report so as to avoid duplication in information submitted to you.

We did develop that your subject does have a personal line of credit which opened in 1979 through a local bank in Huntington Beach but the line of credit is rated only through TRW per banking policy. We were told, however, that there was no abuse of the credit or any problems with your subject in connections with overdrafts or financial problems.

We also developed that your subject has a line of credit regarding a Bank Americard but ratings are given out of B of A's offices in Pasadena by mail only with the signature of the cardholder needed.

Please refer to the attached newspaper article from the Evening Outlook Newspaper dated 3-30-76 involving William Posnett Lynas III whose age was indicated as 41 at the time of the newspaper article. We are including a copy of this newspaper article for your evaluation.

We interviewed the owner of the industrial complex building located at 7602 Talbert in Huntington Beach where the business known as Computers for the Physically Handicapped is located in Unit #5. This source has known your subject for approximately one year and indicated that Computers for the Physically Handicapped have been leasing at this location for at least two years. This source estimates that the office space in unit #5 is approximately 1040 square feet. The lease is on a year to year basis and is paid ahead of time. This source was not that familiar with your subject but had no criticism whatsoever of the firm called Computers for the Physically Handicapped located in unit #5. She was aware that Clarice Traylor was the secretary for the business and would be in a much better position to give us specific details as to the nature of the business. This source had never heard of Sanyl Trust Estate but was aware that your subject was in some way connected with Computers for the Physically Handicapped business.

This source did not know whether Computers for the Physically Handicap designed or manufacture equipment for the handicapped. They pay their monthly rent(lease)of $315 on time and for the most part, ahead of time.

Please note that we did not attempt to make contact with your subject per instructions and were therefore not able to secure additional business sources for interviewing. Again, please refer to our report to you under separate cover on Clarice Marian Traylor for information in connection with Sanyl International Management Company.

Per instructions, we made a call back to Mr. Jerome Snyder of your company on 9-22-80 and spoke with him briefly. He stated that he would call us back. Shortly thereafter, we did receive a telephone call from Mr. Bob Buchsbaum, Financial Consultant of your firm who stated that he was authorized to discuss our findings with him. He at first desired to record our conversation but this was decided against. We therefore discussed the above findings with Mr. Buchsbaum and suggested to him further handling through Los Angeles Courts in order to determine the outcome of the above mentioned 1976 court action. However, Mr. Buchsbaum asked us at this point to close our handling and submit our findings in writing for his evaluation. Again, we do highly suggest that court records be searched in the Los Angeles area regarding the 1976 court action.

N.J. Cassil/Santa Ana
NJC/kw
lcc

EVENING OUTLOOK Tues., March 30, 1976-5

Cocaine Smuggler Sentenced

By United Press International

A former Burbank resident imprisoned in Switzerland for nearly four years while fighting extradition was sentenced in Los Angeles Monday to nine years in prison for smuggling 55 pounds of cocaine into the United States.

William Posnett Lynas III, 41, was sentenced by U.S. District Court Judge Manuel L. Real who also placed Lynas on 20 years' probation.

A federal court jury convicted Lynas on four felony counts following a three-day trial. Lynas, who refused to testify, contended that he was framed by the Central Intelligence Agency because he was familiar with CIA operations in Chile during the Marxist regime of Salvador Allende.

Assistant U.S. Attorney Jan Lawrence Handzlik said Lynas mailed film canisters containing $3 million worth of cocaine from Peru and Chile between Oct. 27, 1970, and Oct. 21, 1971. Nearly 300 canisters containing three ounces of cocaine each were sent to a post office in West Los Angeles.

WFI CORPORATION
Offshore Banking Specialists
2049 Century Park East
Los Angeles, California 90067
Telex: 69-8683
Telephone: (213) 553-8700

September 25, 1980

W. Posnett Lynas, III
U.S. Agent
Sanyl International Management
919 Bayside Drive, M-3
Newport Beach, CA 92662

Re: Proposed Purchase of Chase Overseas Bank Ltd.

Dear Mr. Lynas:

We have had an opportunity to review the background report which we have commissioned on Clarice M. Traylor and Sanyl International Management and have determined that under your proposed form of ownership it would be impossible for us to sell Chase Overseas Bank Ltd. to either Sanyl Trust Estate or Clarice M. Traylor.

The reason for this is as follows:

Section 101B of the Montserrat Banking Ordinance Number 14 of 1978 states that: "Any person who has been sentenced by a court in any country to a term of imprisonment for an offense involving dishonesty and has not received a full pardon for that offense shall not, without the express authorization of the Governor, act or continue to act as a director, manager, secretary or other employee of any financial institution."

We acknowledge the fact that Clarice M. Traylor does not have a criminal record nor has she been sentenced by a court for an offense involving dishonesty; however, you have.

We have a copy of an indictment and conviction records, with positive identification stating that you have violated 21 USC 952(A), importing into the United States controlled substances, for which you have received a sentence of probation for twenty years.

Our background report on Mrs. Traylor indicates that she is an employee of Sanyl International Management and operates this organization under your direction and control. We believe that the Government of Montserrat would take a dim view of us transferring ownership of the bank to Mrs. Traylor with knowledge of this fact, regardless of the fact that Mrs. Traylor has signed a sworn affidavit attesting to the fact that she is not operating the bank for anyone other than herself or any third party.

We have enclosed a copy of the except from the Banking Ordinance highlighting Section 10.1(b) for your information. The Ordinance states that once you have received a full pardon for that offense, you will then be able to be in a position to govern the affairs of an offshore bank incorporated and licensed in Montserrat.

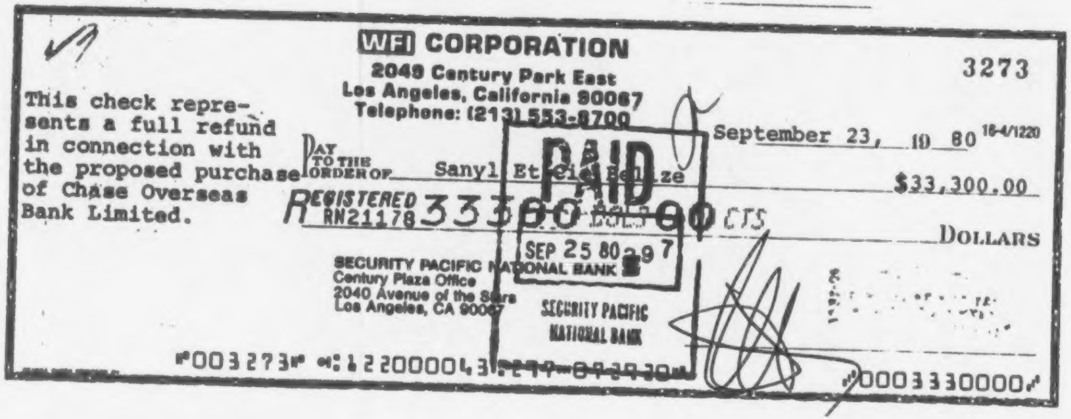
We appreciate your interest.

Sincerely,

JEROME SCHNEIDER, for
WFI Corporation

JS:sab

Enclosure



This check represents a full refund in connection with the proposed purchase of Chase Overseas Bank Limited.

WFI CORPORATION
2049 Century Park East
Los Angeles, California 90067
Telephone: (213) 553-8700

3273

September 23, 19 80 16-4/1220

PAY TO THE ORDER OF Sanyl Et Cie Belize $33,300.00

REGISTERED RN21178 33300 DOLS 00 CTS DOLLARS

SECURITY PACIFIC NATIONAL BANK
Century Plaza Office
2040 Avenue of the Stars
Los Angeles, CA 90067

PAID
SEP 25 80 297
SECURITY PACIFIC NATIONAL BANK

SECURITY PACIFIC NATIONAL BANK

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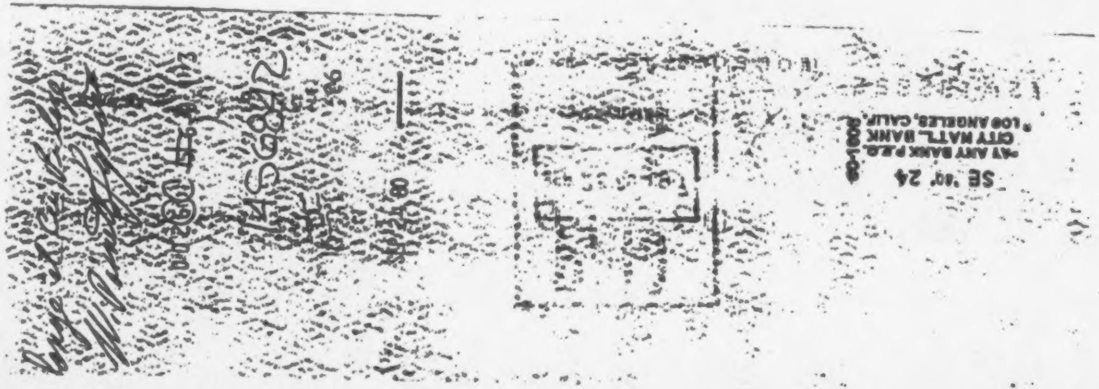

RECEIVED

Government of Anguilla

Official Gazette

Published by Authority

Vol. 13 28 January 1983 No. 1

NOTICES (CONT'D)

THE BANKING ACT NO. 19 OF 1967

Under Section 19 (4) of the Banking Act 1967 it is provided that the Minister shall publish annually in the Gazette the name of each financial institution that has paid the Licence fee required under Section 19 (1)

The following financial institutions paid the relevant licence fee for 1982:-

Trade Continental Bank & Trust Limited
First Gulf Bank & Trust (West Indies) Ltd
Western National Bank & Trust (West Indies) Ltd
Coastal National Bank & Trust (W.I.) Ltd
Femis Bank (Anguilla) Ltd
National Caribbean Bank Ltd
National Trust Bank (W.I.) Ltd
Eastern Maritime Bank Limited
Interbank (W.I.) Ltd
American National Bank & Trust (W.I.) Ltd
Surety National Bank & Trust Co. (W.I.) Ltd
Swiss Investment Bank & Trust Co. (W.I.) Ltd
Swiss-Arab Bank & Trust Co. (W.I.) Ltd
First Republic Bank & Trust Co. (W.I.) Ltd.
Manufacturers Bank & Trust Co. (.W.I.) Ltd
Gryphon Bank & Trust Co. Ltd
Consolidated Dutch-German Bank & Trust Co. (W.I.) Ltd
Union Bank & Trust Co. (W.I.) Ltd
United Investment Bank Ltd.
Overseas Bank & Trust (W.I) Ltd
First Caribbean Bank & Trust (W.I.) Ltd
Swiss Caribbean Bank & Trust (W.I.) Ltd
First Investment & Trust Bank (W.I.) Ltd
Interstate Development & Trust (W.I.) Ltd
First International Bank & Trust (W.I.) Ltd
Swiss Overseas Bank & Trust (W.I.) Ltd
Fidelity International Bank & Trust (W.I.) Ltd
Commonwealth Exchange Bank & Trust (W.I.) Ltd
Astor Bank International Ltd
Harmony Bank & Trust International Ltd.
Maritime Bank (Anguilla) Ltd
Churchill Bank & Trust Limited
Pacific National Bank & Trust (West Indies) Ltd
Colfax Banking Corporation Limited
First Canadian Bank & Trust (W.I.) Ltd
Western Merchants Bank & Trust (W.I.) Ltd
First Chase Bank & Trust (W.I) Ltd
American Investment Bank (West Indies) Ltd
Zurich Investment Bank (West Indies) Ltd
City National Bank & Trust Co. (W.I) Ltd
Century Bank & Trust Co. (W.I.) Ltd
First Commercial Bank (W.I.) Ltd
Zurich International Bank (Anguilla) Ltd
Fiduciary International Bank (Anguilla) Ltd
Mandarian Overseas Bank (W.I.) Ltd
Caribbean Commercial Bank
Barclays Bank International Ltd
Bank of America National Trust
Owens Bank Limited
Freezone Bank (Anguilla) Ltd
International Investment Bank
Providence Bank & Trust Ltd.
First Florida Bank of Anguilla Ltd
Atlas Metals Bank & Trust (W.I.) Ltd
Antillean National Bank (West Indies) Ltd
Union Credit Bank (West Indies) Ltd
International Gold Exchange Bank & Trust Co. (W.I.) Ltd
Midcontinental Bank & Trust (West Indies) Ltd
U S Arabian Bank & Trust (W.I.) Ltd
Anglo Cathay Banking Corporation Ltd
Geneva International Bank (W.I.) Ltd
First Fidelity Bank & Trust (W.I.) Ltd

EXHIBIT "C"

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581
(202) 254-6354

Susan M. Phillips
Acting Chairman

June 6, 1983

PERM. SUBCOMMITTEE
RECEIVED
JUN 6 1983

Honorable William V. Roth, Jr.
Chairman
Committee on Governmental Affairs
Senate Permanent Subcommittee on Investigations
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of May 19, 1983, inviting the Commodity Futures Trading Commission to comment on the difficulties the Commission encounters in attempting to regulate foreign persons on U.S. markets who rely on their domestic secrecy laws to escape regulatory scrutiny. The Commission believes this is an important issue and commends your Subcommittee's efforts in investigating the uses and abuses of offshore banks and companies.

As you are aware, the Commission is responsible for maintaining orderly commodity futures and options markets. See Section 3 of the Commodity Exchange Act, as amended. In order to monitor conditions in the markets effectively, the Commission must be able to gather and assess current trading data. The Commission's market surveillance program seeks to identify major market participants and to obtain accurate and current information concerning their trading activities. This information permits the Commission to ascertain in a timely manner whether the markets are functioning normally or whether there exists any threat of congestion or other abnormal market condition warranting remedial action by the Commission. In large measure, the Commission gathers market information through its routine reporting and special call requirements set forth in Parts 15 through 21 of its regulations, 17 CFR Parts 15-21 (1982).

In employing its reporting and special call requirements, the Commission has experienced difficulties in obtaining critical market information from foreign brokers and foreign traders. The Commission has encountered problems in having Commission communications delivered on a timely basis to foreign market participants in certain foreign countries. In order to ameliorate this problem, the Commission in 1980 adopted Rule 15.05, 17 C.F.R. § 15.05 (1982), under which the Commission may communicate its need for information through domestic futures commission merchants who are designated as the agents of foreign brokers, customers of foreign brokers and/or foreign traders, for purposes of accepting delivery and service of Commission communications under the Rule.

The Commission's ability to receive timely, accurate and verifiable information has also been impaired by the tradition of commercial secrecy which exists in many foreign countries. Indeed, in enforcement actions which the Commission has brought against foreign brokers and foreign traders for failure to provide information requested in Commission special calls or requests for information, respondents have relied on the Swiss or British secrecy laws as a defense.[1] These kinds of situations hamper the Commission in discharging its regulatory responsibilities promptly, particularly in identifying persons who may potentially be in a position to disrupt the markets. In addition, the absence of critical market information might on occasion compel the Commission to take market intervention actions that, if all the facts were known, would be shown to be unnecessary.

It is for these reasons that the Commission, on October 13, 1982, adopted Rule 21.03 (47 Fed. Reg. 44998), based on its determination that additional procedures were needed in order to acquire in a timely fashion essential market data concerning futures and options trading on United States exchanges from all market participants. Under Rule 21.03, a futures commission merchant ("FCM"), trader or foreign broker is required to provide to the Commission upon special call pertinent market information concerning its options and futures trading. The rule includes within its provisions FCMs and domestic traders in addition to foreign brokers and foreign traders. If the FCM, trader or foreign broker fails to respond as required to the special call, the Commission may direct the appropriate exchange and all FCMs to prohibit further trades on the exchange and in the commodity delivery months or option expiration dates specified in the call for or on behalf of the FCM, trader or foreign broker named in the call, unless such trades offset existing open contracts of such FCM, trader or foreign broker.

The Commission limited the application of this rule to instances where the information may be relevant information in enabling the Commission to determine whether the threat of a market manipulation, corner, squeeze or other market disorder exists and where books and records of the FCM, trader or foreign broker upon whom the special call is made are not open at all times to inspection in the United States by any representative of the Commission.

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[1] See, e.g., In the Matter of Wiscope, S.A. [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,785 (1979) vacated on other grounds sub nom., Wiscope, S.A. v. Commodity Futures Trading Commission, 604 F.2d 764 (2d Cir. 1979); In the Matter of Banque Populaire Suisse [1980-1982 Decisions], Comm. Fut. L. Rep. CCH ¶ 21,255 (1981); In the Matter of Alan J. Ridge & Co., Ltd., CFTC Docket No. 80-16 (April 11, 1983).

The trading limitation imposed under Commission Rule 21.03 is intended to preserve the status quo by prohibiting the FCM, trader or foreign broker from adding new positions for the delivery months or option expiration dates. This procedure, which does not call for a hearing prior to the Commission's acting, provides the Commission with an effective means of enforcing special calls in appropriate circumstances. Where information is not furnished that may be relevant in enabling the Commission to determine whether the threat of a market manipulation, corner, squeeze or other market disorder exists, this procedure allows the Commission immediately to prevent a FCM, trader or foreign broker from further building its position. Since the adoption of Rule 21.03, the Commission has not encountered a situation where it has found it necessary to issue a special call under the Rule.

With respect to your interest in the amount of foreign source trading involved in U.S. commodity markets, please find attached tables which indicate the average number of foreign traders and average percentage of open interest held by foreign traders by commodity group for the periods June 1976 - February 1977 and January 1978 - February 1980. The Commission's Divison of Economics and Education currently is compiling for you similar statistics for March 31, 1983, which I will forward to you as soon as possible. The data currently being compiled will also identify the various countries in which foreign traders are located.

Again, thank you for the opportunity to address these issues. Please accept this response as testimony in your hearings. If you have any other questions please let me know.

Sincerely,

Susan M. Phillips

Susan Phillips

TABLE 1

Average number of foreign traders per month end for June 30, 1976, through February 28, 1977, and January 31, 1978 through February 28, 1980, for all countries.[1]

Commodity Group[2]	June 1976 - February 1977	January 1978 - February 1980
Grains and the Soybean Complex	164	143
Livestock and Meat	35	40
Foodstuff - Domestic	18	24
Foodstuff - Foreign	91	93
Financial Instruments	16	82
Industrial Goods	128	84
Precious Metals	102	123
All Commodities	554	589

1/ Underlying data for this table was obtained from CFTC "01" report forms, which are filed daily by all futures commission merchants and list all reportable sized futures positions carried. The Commission's Division of Economics and Education notes that comparisons of data between time periods should be made cautiously, since Commission reporting requirements changed between 1977 and 1980. *See* Table 3.

2/ *See* Table 4.

TABLE 2

Average percentage of monthend open interest for selected commodity groups held by reportable foreign traders for June 30, 1976 through February 28, 1977, and January 31, 1978 through February 28, 1980.[1]

Commodity Group[2]	June 1976 - February 1977		January 1978 - February 1980	
	Long	Short	Long	Short
Grains and Soybean Complex	3.7	3.5	1.4	0.8
Livestock and Meat	4.2	1.9	3.1	1.0
Domestic Foodstuffs	6.2	3.9	5.7	3.9
Foreign Foodstuffs	24.3	26.0	22.2	24.8
Financial Instruments	5.2	5.9	4.1	2.8
Industrial Goods	11.5	5.6	6.4	8.0
Precious Metals	1.5	2.2	3.7	3.5

---

[1] Underlying data for this table was obtained from CFTC "01" report forms, which are filed daily by all futures commission merchants and list all reportable-sized futures positions carried. The Commission's Division of Economics and Education notes that comparisons of data between time periods should be made cautiously, since Commission reporting requirements changed between 1977 and 1980. *See* Table 3.

[2] *See* Table 4.

TABLE 3

Reporting Levels as of February 28, 1980.

Wheat 1/	500,000 bushels
Corn 1/	500,000 bushels
Oats	200,000 bushels
Soybeans 1/	500,000 bushels
Soybean Oil 2/ 4/	100 contracts
Soybean Meal 2/ 4/	100 contracts
Live Cattle 2/ 4/	100 contracts
Live Hogs 2/	50 contracts
Sugar 2/	50 contracts
Cotton	5,000 bales
Copper 2/ 4/	100 contracts
Gold 2/ 4/	100 contracts
Silver 3/ 5/	250 contracts
U.S. Silver Coins 2/	50 contracts
All other Commodities	25 contracts

1/ Raised from 200,000 bushels June 1, 1977.

2/ Raised from 25 contracts June 1, 1977, to 50 contracts.

3/ Raised from 25 contracts June 1, 1977, to 100 contracts.

4/ Raised from 50 contracts April 1, 1979, to 100 contracts.

5/ Raised from 100 contracts April 1, 1979, to 250 contracts.

TABLE 4

Commodity Group Definitions as of February 28, 1980.

1. Grains and the soybean complex - wheat, corn, oats, soybeans, soybean meal, and soybean oil

2. Livestock and Meat - live cattle, feeder cattle, hogs and pork bellies

3. Foodstuff domestic - potatoes, eggs and orange juice

4. Foodstuff foreign - coffee, cocoa and sugar

5. Financial instruments - GNMA's, T-bills and foreign currencies

6. Industrial goods - cotton, lumber, plywood, copper, palladium and petroleum

7. Precious metals - gold, silver, platinum and silver coins

COMMODITY FUTURES TRADING COMMISSION
2033 K Street, N.W., Washington, D.C. 20581
(202) 254-6354

Susan M. Phillips
Acting Chairman

June 24, 1983

PERM. [illegible]
RECEIVED
[illegible]

Honorable William V. Roth, Jr.
Chairman
Committee on Governmental Affairs
Senate Permanent Subcommittee on Investigations
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman,

This letter is written in further response to your letter dated May 19, 1983 inviting the Commodity Futures Trading Commission, among other things, to provide information on the amount of foreign source trading involved in United States commodity markets. In a letter to you dated June 6, 1983, the Commission enclosed tables which indicated the average number of foreign traders and average percentage of open interest held by foreign traders by commodity group for certain periods during 1976 through 1980. Enclosed are tables which contain similar statistics for May 24, 1983. The enclosed tables also identify the various country groups in which foreign traders are located.

Please accept this response as testimony in your hearings. And if the Commission can further assist your efforts in investigating the uses and abuses of offshore banks and companies, please let me know.

Sincerely,

Susan M. Phillips

Susan M. Phillips

Enclosures

TABLE 1A

Number of foreign traders holding reportable positions on May 24, 1983.1/

Commodity Group2/	All foreign countries	Bermuda and Caribbean Islands	Central and South America	Europe and Canada	Far East and Pacific	Mideast and Africa
Grains and the Soybean Complex	115	2	24	79	9	1
Livestock and Meat	18	1	1	12	3	1
Foodstuff - Domestic	5	0	1	3	0	1
Foodstuff - Foreign	148	6	16	97	25	5
Financial Instruments & Currencies	310	16	25	218	23	24
Industrial Goods	79	4	6	55	13	3
Precious Metals	77	3	3	54	7	10
All Commodities	625	23	69	433	72	32

1/ This data supplements that provided in Table 1 of the Commission's June 6, 1983 letter. In addition to the total number of foreign traders, data is provided for particular groups of countries. As in Table 1, underlying data for this table was obtained from CFTC "01" report forms, which are filed daily by all futures commission merchants and list all reportable sized futures positions carried. The Commission's Division of Economics and Education notes that comparisons of data between time periods should be made cautiously, since Commission reporting requirements changed between 1977 and 1983. See Tables 3 and 3A.

2/ See Table 4A.

TABLE 2A

Percentage of open interest for selected commodity groups held by reportable foreign traders on May 24, 1983.[1]

Commodity Group[2]	All foreign countries		Bermuda and Caribbean Islands		Central and South America		Europe and Canada		Far East and Pacific		Mideast and Africa	
	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short
Grains and the Soybean Complex	26.6	22.4	0.3	0.6	6.9	2.7	18.2	16.1	1.0	3.0	0.2	0
Livestock and Meat	1.4	0.8	0.2	0.1	0	0	1.1	0.5	*	*	0.1	0.1
Foodstuff - Domestic	4.6	0.6	0	0	0.9	0	1.6	0.6	0	0	2.2	0
Foodstuff - Foreign	29.6	44.7	0.3	0.3	0.5	2.0	20.6	36.8	8.1	5.4	0.2	0.1
Financial Instruments & Currencies	13.0	3.5	0.4	0.2	0.6	0.7	9.7	2.5	1.4	0.1	0.8	*
Industrial Goods	3.4	5.5	0.1	0.6	0.1	0.2	2.5	4.3	0.6	0.4	0.2	0
Precious Metals	4.8	4.9	*	*	0.1	0	3.6	4.1	0.2	0.2	0.9	0.6
All Commodities	12.4	10.5	0.3	0.3	1.1	0.8	8.9	8.2	1.1	1.6	0.5	0.1

---

[1] This data supplements that provided in Table 2 of the Commission's June 6, 1983 letter. In addition to the total number of foreign traders, data is provided for particular groups of countries. As in Table 2, underlying data for this table was obtained from CFTC "01" report forms, which are filed daily by all futures commission merchants and list all reportable sized futures positions carried. The Commission's Division of Economics and Education notes that comparisons of data between time periods should be made cautiously, since Commission reporting requirements changed between 1977 and 1983. *See* Tables 3 and 3A.

See Table 4A.

Less than 0.05 percent.

TABLE 3A

Reporting Levels as of May 24, 1983

Reporting levels for May 24, 1983 are the same as those listed in Table 3 of the Commission's June 6, 1983 letter, with the following additions:

Long-Term U.S. T-Bonds[1]	50 Contracts
GNMA Mortgages[2]	50 Contracts

---

[1] Raised from 25 contracts March 15, 1981, to 50 contracts.

[2] Raised from 25 contracts March 15, 1981, to 50 contracts.

TABLE 4A

Commodity Group Definitions as of May 24, 1983.

1. Grains and the soybean complex - wheat, corn, oats, rough rice, soybeans, soybean meal, and soybean oil

2. Livestock and Meat - live cattle, feeder cattle, live hogs and frozen pork bellies

3. Foodstuff domestic - potatoes and orange juice

4. Foodstuff foreign - coffee, cocoa and sugar

5. Financial instruments and Currencies - Treasury Bonds, Treasury Bills, Treasury Notes, GNMA Mortgages, Domestic Certificates of Deposit, Eurodollars, Value Line Stock Index, S&P Stock Index, NYSE Stock Index, Canadian Dollar, French Franc, Swiss Franc, Deutsche Mark, Mexican Peso, Pound Sterling and Japanese Yen

6. Industrial goods - cotton, lumber, copper, palladium, #2 heating oil, crude oil, and gasoline

7. Precious metals - gold, silver and platinum

Table 5A

COUNTRIES REPRESENTED WITHIN EACH COUNTRY GROUP

Bermuda and Caribbean Islands

Bermuda
Bahamas
Cayman Islands
Netherlands Antilles
British Virgin Islands
West Indies

Central and South America

Argentina
Bolivia
Brazil
Chile
Columbia
Costa Rica
Dominican Republic
Ecuador
Guatemala
Mexico
Panama
Uraguay
Venezuala

Europe and Canada

Austria
Belgium
Canada
Denmark
England
France
Germany
Greece
Holland
Ireland
Italy
Liechtenstein
Netherlands
Portugal
Spain
Sweden
Switzerland

Far East and Pacific Islands

Australia
China
Hong Kong
Indonesia
Japan
Philippines
Singapore

Mideast and Africa

Bahrain
Central African Republic
Egypt
Israel
Jordon
Kuwait
Lebanon
Saudi Arabia
United Arab Republic
